UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

Or

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

For the transition period from to

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

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

6350 South 3000 East

Salt Lake City, Utah 84121

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

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

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

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

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

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

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

There were 23,447,391 shares of the Registrant s common stock, par value $0.0001, outstanding on October 25, 2012.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.

Consolidated Balance Sheets (Unaudited)

(in thousands)

	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 72,469	$ 96,985
Restricted cash	2,060	2,036
Accounts receivable, net	14,020	13,501
Inventories, net	21,390	22,993
Prepaid inventories, net	1,668	1,027
Prepaids and other assets	13,550	12,651
Total current assets	125,157	149,193
Fixed assets, net	23,084	25,322
Goodwill	2,784	2,784
Other long-term assets, net	2,643	2,260
Total assets	$ 153,668	$ 179,559
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 43,302	$ 70,332
Accrued liabilities	40,508	47,902
Deferred revenue	28,814	27,978
Line of credit	17,000	17,000
Capital lease obligations, current		110
Total current liabilities	129,624	163,322
Capital lease obligations, non-current		2
Other long-term liabilities	2,765	2,998
Total liabilities	132,389	166,322
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 - 26,477 and 26,241		
Outstanding shares - 23,447 and 23,279	2	2
Additional paid-in capital	355,992	353,368
Accumulated deficit	(255,883)	(261,765)
Treasury stock:		
Shares at cost - 3,030 and 2,962	(78,832)	(78,368)

Total stockholders equity		21,279		13,237
Total liabilities and stockholders equity	$	153,668	$	179,559

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Operations and Comprehensive Income (Loss)

(Unaudited)

(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Revenue, net				
Direct	$ 34,215	$ 34,749	$ 109,048	$ 116,353
Fulfillment partner	221,137	204,989	648,207	623,847
Total net revenue	255,352	239,738	757,255	740,200
Cost of goods sold				
Direct(1)	30,684	32,472	99,422	105,733
Fulfillment partner	178,126	168,893	520,614	506,240
Total cost of goods sold	208,810	201,365	620,036	611,973
Gross profit	46,542	38,373	137,219	128,227
Operating expenses:				
Sales and marketing(1)	14,899	13,822	42,886	42,902
Technology(1)	16,085	17,171	46,845	50,639
General and administrative(1)	13,828	15,321	43,166	50,032
Restructuring	(45)		53	
Total operating expenses	44,767	46,314	132,950	143,573
Operating income (loss)	1,775	(7,941)	4,269	(15,346)
Interest income	30	23	86	121
Interest expense	(194)	(662)	(655)	(1,968)
Other income, net	1,213	553	2,364	962
Income (loss) before income taxes	2,824	(8,027)	6,064	(16,231)
Provision (benefit) for income taxes	131	(240)	182	(202)
Net income (loss)	$ 2,693	$ (7,787)	$ 5,882	$ (16,029)
Deemed dividend related to redeemable common stock				(12)
Net income (loss) attributable to common shares	$ 2,693	$ (7,787)	$ 5,882	$ (16,041)
Net income (loss) per common share basic:				
Net income (loss) attributable to common shares basic	$ 0.11	$ (0.33)	$ 0.25	$ (0.69)
Weighted average common shares outstanding basic	23,447	23,276	23,382	23,253
Net income (loss) per common share diluted:				
Net income (loss) attributable to common shares diluted	$ 0.11	$ (0.33)	$ 0.25	$ (0.69)
Weighted average common shares outstanding diluted	23,754	23,276	23,511	23,253
Comprehensive income (loss)	$ 2,693	$ (7,787)	$ 5,882	$ (16,029)

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(1) Includes stock-based compensation as follows (Note 7):				
Cost of goods sold direct	$ 74	$ 47	$ 200	$ 134
Sales and marketing	108	80	260	289

Technology		218		171		585		534
General and administrative		580		403		1,579		1,454
Total	$	980	$	701	$	2,624	$	2,411

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Changes in Stockholders Equity

(Unaudited)

(in thousands)

	Common stock		Additional Paid-in	Accumulated	Treasury stock		
	Shares	Amount	Capital	Deficit	Shares	Amount	Total
Balances at December 31, 2011	26,241	$ 2	$ 353,368	$ (261,765)	2,962	$ (78,368)	$ 13,237
Net income				5,882			5,882
Stock-based compensation to employees and directors			2,624				2,624
Common stock issued upon vesting of restricted stock	236						
Purchase of treasury stock					68	(464)	(464)
Balance at September 30, 2012	26,477	$ 2	$ 355,992	$ (255,883)	3,030	$ (78,832)	$ 21,279

See accompanying notes to 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,	
	2012	**2011**	**2012**	**2011**
Cash flows from operating activities:				
Net income (loss)	$ 5,882	$ (16,029)	$ 2,473	$ (1,170)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	11,935	12,472	15,813	16,581
Realized gain from sale of marketable securities	(8)		(8)	
Loss (gain) on disposition of fixed assets	72		72	(14)
Stock-based compensation to employees and directors	2,624	2,411	3,264	3,697
Amortization of deferred loan costs and debt discount	55	77	105	162
Loss from early extinguishment of debt		54	1,199	54
Restructuring charges (reversals)	53		53	(433)
Changes in operating assets and liabilities:				
Restricted cash	(24)	159	323	159
Accounts receivable, net	(519)	5,115	(5,575)	(57)
Inventories, net	1,603	12,904	(2,180)	15,183
Prepaid inventories, net	(641)	667	(253)	1,296
Prepaids and other assets	(314)	(3,218)	2,448	(1,674)
Other long-term assets, net	(1,160)	12	(1,332)	271
Accounts payable	(26,958)	(24,775)	761	(3,253)
Accrued liabilities	(7,478)	(3,507)	2,981	567
Deferred revenue	836	(2,847)	7,634	430
Other long-term liabilities	705	205	848	(55)
Net cash provided by (used in) operating activities	(13,337)	(16,300)	28,626	31,744
Cash flows from investing activities:				
Purchases of marketable securities	(69)	(119)	(110)	(155)
Sale of marketable securities	154		154	
Proceeds from sale of fixed assets	56		56	
Purchases of intangible assets	(6)	(7)	(3)	(23)
Expenditures for fixed assets, including internal-use software and website development	(10,563)	(6,344)	(12,960)	(7,538)
Net cash used in investing activities	(10,428)	(6,470)	(12,863)	(7,716)
Cash flows from financing activities:				
Payments on capital lease obligations	(112)	(654)	(188)	(722)
Drawdowns on line of credit		17,000		17,000
Capitalized financing costs		(121)	(19)	(121)
Proceeds from finance obligations		1,429		3,235
Payments on finance obligations		(3,390)	(21,528)	(4,231)
Paydown on direct financing arrangement	(175)	(160)	(231)	(211)
Payments to retire convertible senior notes		(34,615)		(34,615)
Purchase of treasury stock	(464)	(1,602)	(466)	(1,606)
Purchase of redeemable stock				(26)
Exercise of stock options				(1)
Net cash used in financing activities	(751)	(22,113)	(22,432)	(21,298)
Net increase (decrease) in cash and cash equivalents	(24,516)	(44,883)	(6,669)	2,730
Cash and cash equivalents, beginning of period	96,985	124,021	79,138	76,408

Cash and cash equivalents, end of period	$ 72,469	$ 79,138	$ 72,469	$ 79,138
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid	$ 436	$ 1,814	$ 991	$ 2,750
Taxes paid	139	260	139	260
Non-cash investing and financing activities:				
Change in fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	$ 581	$ 270	$ 278	$ 155
Equipment acquired under finance obligations		5,077		5,676
Lapse of rescission rights of redeemable stock		582		842

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

As used herein, Overstock.com, we, our and similar terms include Overstock.com, Inc. and its subsidiaries, unless the context indicates otherwise. The accompanying unaudited consolidated financial statements have been prepared by us 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, 2011. 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, 2012 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

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

Use of estimates

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

Cash equivalents

We classify all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were $48.1 million and $81.2 million at September 30, 2012 and December 31, 2011, 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. Restricted cash was $2.1 million and $2.0 million at September 30, 2012 and December 31, 2011, respectively, and was held primarily in cash.

Fair value of financial instruments

Our financial instruments, including cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these instruments. We are party to a Financing Agreement with U.S. Bank dated December 22, 2009 (as amended to date, the Financing Agreement). Our Financing Agreement is also carried at face value, which approximates its fair value due to its variable interest rate.

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 following fair-value hierarchy:

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

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

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observable in active markets; and

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

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

The fair value of these financial instruments was determined using the following levels of inputs as of September 30, 2012 (in thousands):

	Fair Value Measurements at September 30, 2012:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$ 48,129	$ 48,129	$	$
Trading securities held in a rabbi trust (1)	248	248		
Total assets	$ 48,377	$ 48,377	$	$
Liabilities:				
Restructuring Accrual (2)	$ 66	$	$	$ 66
Deferred compensation accrual rabbi trust (3)	244	244		
Total liabilities	$ 310	$ 244	$	$ 66

The fair value of these financial instruments was determined using the following levels of inputs as of December 31, 2011 (in thousands):

	Fair Value Measurements at December 31, 2011:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$ 81,159	$ 81,159	$	$
Trading securities held in a rabbi trust (1)	302	302		
Total assets	$ 81,461	$ 81,461	$	$
Liabilities:				
Deferred compensation accrual rabbi trust (3)	302	302		
Total liabilities	$ 302	$ 302	$	$

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(1) Trading securities held in a rabbi trust are included in Other current and long-term assets in the consolidated balance sheets.

(2) The fair value was determined based on the income approach, in which we used internal cash flow projections over the life of the underlying lease agreement discounted based on a credit adjusted risk-free rate of return. See the roll forward related to the restructuring accrual at Note 3 Restructuring Expense.

(3) Non qualified deferred compensation for rabbi trust is included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheets.

Restricted investments

In December 2009, we implemented a Non Qualified Deferred Compensation Plan (the NQDC Plan) for senior management. Deferred compensation amounts are invested in mutual funds held in a rabbi trust and are restricted for payment to the participants of the NQDC Plan. We account for our investments held in the trust in accordance with Accounting Standards Codification (ASC) No. 320 *Investments Debt and Equity Securities* . The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled $248,000 at September 30, 2012 and are included in Other current and long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three and nine months ended September 30, 2012 and 2011.

Accounts receivable

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

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Allowance for doubtful accounts

From time to time, 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 $738,000 and $574,000 at September 30, 2012 and December 31, 2011, respectively.

Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At September 30, 2012 and December 31, 2011, 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.

Our accounts receivable are derived primarily from revenue earned from customers located in the United States. We maintain an allowance for doubtful accounts based upon the expected collectability of accounts receivable.

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 represent inventories paid for in advance of receipt. Prepaid inventories were $1.7 million and $1.0 million at September 30, 2012 and December 31, 2011, respectively.

Prepaids and other assets

Prepaids and other assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs, as well as investments in precious metals. Total prepaids and other assets were $13.6 million and $12.7 million at September 30, 2012 and December 31, 2011, respectively.

Fixed assets

Fixed assets, which include assets such as technology infrastructure, internal-use software, website development, furniture and fixtures 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, as follows:

	Life (years)
Computer software	2-3
Computer hardware	3
Furniture and equipment	3-5

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Cost of goods sold - direct	$ 123	$ 137	$ 350	$ 583
Technology	3,371	3,766	10,570	11,009
General and administrative	345	307	1,015	880
Total depreciation and amortization, including internal-use software and website development	$ 3,839	$ 4,210	$ 11,935	$ 12,472

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, 2012 and 2011, we capitalized $3.0 million and $2.3 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was $2.0 million and $2.1 million for those respective periods. During the nine months ended September 30, 2012 and 2011, we capitalized $6.8 million and $7.8 million, respectively, of such costs and had amortization of $6.3 million and $6.1 million for those respective periods.

Revenue recognition

We derive our revenue primarily from two sources: direct revenue and fulfillment partner revenue, including listing fees and commissions collected from products being listed and sold through our cars listing business, and from advertising on our shopping, travel and insurance pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and fulfillment 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 or those of our fulfillment partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment. We review

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

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 fulfillment 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.

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

Direct revenue

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

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Fulfillment partner revenue

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

Fulfillment partner revenue also includes revenue from our other businesses, which include our online site for listing cars for sale, our travel shopping site, our insurance shopping site, our consignment service to suppliers, our online auction site (which was removed from our site in July 2011) and our online site for listing real estate for sale (which was removed from our site in June 2011). Revenue from our other businesses is less than 1% of total net revenues.

Club O loyalty program

We have a customer loyalty program called Club O for which we sell annual memberships. We record membership fees as deferred revenue and we recognize revenue ratably over the membership period. The Club O loyalty program allows members to earn reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program (see Co-branded credit card revenue below for more information). Co-branded cardholders are also Club O members and earn additional reward dollars for purchases made on our Website, and from other merchants. Reward dollars earned may be redeemed on future purchases made through our Website. Club O reward dollars expire 90 days after the customer s Club O membership expires. We account for these transactions as multiple element arrangements and allocate value 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.

We recognize revenue for Club O reward dollars when customers redeem their reward dollars as part of a purchase at our Website. We recognize other income when Club O reward dollars expire or the likelihood of reward dollars being redeemed by a customer is remote (reward dollar breakage). Due to the loyalty program s short history, currently no reward dollar breakage is recognized until the reward dollars expire. However, in the future we plan to recognize such breakage based upon historical redemption patterns.

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

We have entered into 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 life of the credit card relationship. Credit card usage fees are recognized as revenues as actual credit card usage occurs.

Deferred revenue

Customer orders are recorded as deferred revenue prior to delivery of products or services ordered. We record amounts received for Club O 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 revenue 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 income when the likelihood of its redemption becomes remote based on our historical redemption experience. We consider the likelihood of redemption to be remote after 36 months.

Sales returns allowance

We inspect 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 fulfillment 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.

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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 $6.3 million and $10.9 million at September 30, 2012 and December 31, 2011 respectively. The decrease in allowance for returns at September 30, 2012 compared to December 31, 2011 is primarily due to decreased revenues mostly due to seasonality.

Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was $157,000 and $187,000 at September 30, 2012 and December 31, 2011, 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):

Total revenue, net	$ 255,352	100%	$ 239,738	100%	$ 757,255	100%	$ 740,200	100%
Cost of goods sold								
Product costs and other cost of goods sold	196,522	77%	189,074	79%	582,436	77%	573,204	78%
Fulfillment and related costs	12,288	5%	12,291	5%	37,600	5%	38,769	5%
Total cost of goods sold	208,810	82%	201,365	84%	620,036	82%	611,973	83%
Gross profit	$ 46,542	18%	$ 38,373	16%	$ 137,219	18%	$ 128,227	17%

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 $12.8 million and $11.7 million during the three months ended September 30, 2012 and 2011, respectively. For the nine months ended September 30, 2012 and 2011, advertising expenses totaled $37.0 million and $35.9 million, respectively. Prepaid advertising, which consists primarily of prepaid advertising airtime, (included in Prepaids and other assets in the accompanying consolidated balance sheets) was $2.1 million and $1.4 million at September 30, 2012 and December 31, 2011, respectively.

Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on date of grant and recognize compensation expense over the service period for awards expected to vest on a straight line basis. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts will be recorded as an adjustment in the period estimates are revised. 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 possible loss can be estimated, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. We expense legal fees as incurred.

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Restructuring

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

Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis using enacted tax rates in effect for the year in which the differences are expected to affect taxable income.

Deferred tax assets are evaluated for future realization and are reduced by a valuation allowance to the extent that it is more likely than not that the deferred tax asset will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred assets including expectations of future taxable income, the carry-forward periods available for tax reporting purposes, the reversals of our deferred tax liabilities and tax planning strategies, to the extent available. At September 30, 2012 and December 31, 2011, we have a full valuation allowance against our deferred tax assets, net of expected reversals of existing deferred tax liabilities, as we believe it is more likely than not that these benefits will not be realized. Significant judgment is required in making this assessment, and it is very difficult to predict when, if ever, our assessment may conclude that the remaining portion of the deferred tax assets are realizable.

Earnings (loss) per share

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income (loss)	$ 2,693	$ (7,787)	$ 5,882	$ (16,029)

Deemed dividend related to redeemable common stock								(12)
Net income (loss) attributable to common shares	$	2,693	$	(7,787)	$	5,882	$	(16,041)
Net income (loss) per common share basic:								
Net income (loss) attributable to common shares basic	$	0.11	$	(0.33)	$	0.25	$	(0.69)
Weighted average common shares outstanding basic		23,447		23,276		23,382		23,253
Effect of dilutive securities:								
Stock options and restricted stock awards		307				129		
Weighted average common shares outstanding diluted		23,754		23,276		23,511		23,253
Net income (loss) attributable to common shares diluted	$	0.11	$	(0.33)	$	0.25	$	(0.69)

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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,		Nine months ended September 30,	
	2012	2011	2012	2011
Stock options and restricted stock awards	541	985	546	985

Accounting pronouncements issued not yet adopted

In July 2011, the Financial Accounting Standards Board (FASB) issued accounting pronouncement No. 2012-02, Intangibles Goodwill and Other (FASB Accounting Standards Codification Topic 350) permits an entity to make a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. The Accounting Standard Update applies to both public and nonpublic entities and is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. We do not expect this pronouncement to have a material effect on our consolidated financial statements.

3. RESTRUCTURING EXPENSE

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

Restructuring liabilities along with charges (credits) to expense and payments associated with the facilities consolidation and restructuring program are as follows (in thousands):

	Balance at 12/31/2011	Accretion Expense	Net Cash Payments	Adjustments	Balance at 9/30/2012
Lease and contract termination costs	$ 1,491	$ 112	$ (365)	$ 53	$ 1,291

We reversed $45,000 of lease termination costs during the three months ended September 30, 2012 due to changes in our estimate of sublease income as a result of our entering into a new sublease agreement. We incurred $53,000 of lease termination costs during the nine months ended September 30, 2012 due to ceasing the use of some of our office facilities and changes in the estimate of sublease income as a result of our entering into a new sublease agreement. There were no restructuring charges or reversals during the three and nine months ended September 30, 2011.

4. BORROWINGS

U.S. Bank Financing Agreements

We are a party to a Financing Agreement with U.S. Bank National Association (U.S. Bank) dated December 22, 2009 (as amended to date, the Financing Agreement). The maximum credit potentially available under the revolving facility is $20 million. Our obligations under the Financing Agreement and all related agreements are secured by all or substantially all of our assets, excluding our interest in certain litigation. Subject to certain exceptions, the full amount of the revolving facility is expected to be available to us as long as $20 million in the aggregate is maintained on deposit with U.S. Bank. At September 30, 2012 and at the date of this report we maintain $20 million on deposit with U.S. Bank. The obligation of U.S. Bank to make advances under the Financing Agreement is subject to the conditions set forth in the Financing Agreement.

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

The stated termination date of the Financing Agreement is December 31, 2012. The maximum amount potentially available under the Financing Agreement is $20 million, limited to $3 million for cash-collateralized letters of credit and other financial accommodations, and $17 million for advances supported by our non-cash collateral.

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Advances under the Financing Agreement bear interest at one-month LIBOR plus 2.5%. The interest rate for borrowings under the Financing Agreement was 2.75% at September 30, 2012. We have also entered into an interest rate cap agreement with U.S. Bank with an effective date of October 1, 2011 limiting our exposure for one-month LIBOR at 0.5% for the term of the Financing Agreement.

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

Amounts outstanding under the Financing Agreement were $17.0 million at September 30, 2012 and December 31, 2011, and letters of credit totaling $1.9 million and $2.0 million, respectively, 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. At September 30, 2012, we had $20.0 million in compensating cash balances held at U.S. Bank. If we draw on the $20.0 million compensating cash balance, it will constitute a triggering event and result in additional and more restrictive covenants.

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, 2012, $2.2 million was outstanding and $2.8 million was available under the Purchasing Card. At December 31, 2011, $3.4 million was outstanding and $1.6 million was available under the Purchasing Card.

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, 2012, are as follows (in thousands):

Payments due by period		
2012 (remainder)	$	2,033
2013		8,206

2014	8,404
2015	6,814
2016	1,381
Thereafter	183
	$ 27,021

Rental expense for operating leases totaled $2.1 million and $2.0 million for the three months ended September 30, 2012 and 2011, respectively and $6.5 million and $6.1 million for the nine months ended September 30, 2012 and 2011, respectively. Estimated sublease income of $875,000 is expected over the next three years of which $379,000 is anticipated to be received in the next 12 months.

Legal Proceedings

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 in the event 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 equitable remedies and penalties. 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.

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On February 2, 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc., and later amended the complaint to add Lehman Brothers Holdings Inc. as a defendant. The suit alleged that the defendants, who controlled over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as fails to deliver and that the defendants actions caused and continued to cause dramatic declines in the share price of our stock and that the amount of fails to deliver often exceeded our entire supply of outstanding shares. The suit accused the defendants of violations of California securities laws and common law and violations of California s Unfair Business Practices Act. After it filed for bankruptcy on September 2008, we elected not to pursue our claims against Lehman Brothers Holdings. On July 23, 2009, the court sustained defendants demurrer to our amended causes of action for conversion and trespass to chattels. On December 15, 2010, we and the other plaintiffs in the case entered into a settlement agreement with certain of the defendants requiring these defendants to pay in the aggregate $4.5 million to plaintiffs. Other terms of settlement are confidential. At that time, remaining defendants in the suit were Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P., (Goldman Defendants) Merrill Lynch, Pierce, Fenner & Smith, Inc., Merrill Lynch Professional Clearing Corporation (Merrill Lynch Defendants), and Bank of America Securities LLC. On December 15, 2010, we filed a motion to amend our complaint against the Goldman and Merrill Lynch Defendants to add a cause of action based on the New Jersey Racketeer Influenced and Corrupt Organization (RICO) Act. Defendants challenged the RICO claim by demurrer and eventually the court sustained the demurrer. We thereafter entered a settlement agreement with Bank of America Securities LLC, the terms of which are confidential, and have dismissed the action as to that defendant. On August 19, 2011, the remaining defendants filed a motion for summary judgment. On January 10, 2012 the court granted the motion for summary judgment as to all remaining defendants and judgment has been entered. We have appealed. The defendants have applied to the court for reimbursement from us of their allowable court costs in the collective amount of $2.4 million. We believe the full amount applied for is excessive and not permissible under California law. In the trial court we have contested the requested costs amount**.** The court has not heard arguments on the disputed costs amount. The nature of the loss contingencies relating to any court costs ordered against us are described above.

On May 30, 2008 we filed a complaint in New York state court against the New York State Department of Taxation and Finance, its Commissioner, the State of New York and its governor, alleging that a New York state tax law is unconstitutional. The effect of the New York law is to require Internet sellers to collect and remit New York sales taxes on their New York sales even if the seller has no New York tax nexus other than with New York based independent contractors who are Internet advertising affiliates. The complaint asks for the court to declare the law unconstitutional and enjoin its application to us. New York filed a motion to dismiss. We responded to the motion and filed a motion for summary judgment, and both motions were heard simultaneously. On January 12, 2009, the court granted New York s motion to dismiss and denied our motion for summary judgment. We appealed the decision and on November 4, 2010 the New York Appellate Division upheld part of the lower court s ruling rejecting our claims that the law is unconstitutional on its face, but remanded our claims that the law is unconstitutional as applied, for further discovery and proceedings in the lower court. We filed with the New York State Court of Appeals a motion of leave to appeal the portions of the decision upholding the lower court s ruling. On March 15, 2011, the Appellate Division of the New York State Court of Appeals denied our motion for leave to appeal to the New York State Court of Appeals. We have determined not to pursue at the trial court level our claims that the law is unconstitutional as applied. We proceeded with an appeal to the New York State Court of Appeals of the Appellate Division s ruling on our claim that the statute is unconstitutional on its face. On March 26, 2012, the court agreed to hear the case. The New York State Court of Appeals has not yet heard the case.

On August 12, 2008, we along with seven other defendants, were sued in the United States District Court for the Northern District of California, by Sean Lane, and seventeen other individuals, on their own behalf and for others similarly in a class action suit, alleging violations of the Electronic Communications Privacy Act, Computer Fraud and Abuse Act, Video Privacy Protection Act, and California s Consumer Legal Remedies Act and Computer Crime Law. The complaint relates to our use of a product known as Facebook Beacon, created and provided to us by Facebook, Inc. Facebook Beacon provided the means for Facebook users to share purchasing data among their Facebook friends. The parties extended by agreement the time for defendants answer, including our answer, and thereafter, the Plaintiff and Facebook proposed a stipulated settlement to the court for approval, which would resolve the case without requirement of financial contribution from us. On March 17, 2010, over objections lodged by some parties, the court entered an order accepting settlement. Various parties appealed and on September 20, 2012 the Federal Appeals Court for the 9th Circuit upheld the settlement. It is unknown whether the parties will seek further appeal. 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.

On November 14, 2008, we filed suit in Ohio state court against the Ohio Tax Commissioner, the Ohio Attorney General and the Governor of Ohio, alleging the Ohio Commercial Activity Tax is unconstitutional. Enacted in 2005, Ohio s Commercial Activity Tax is based on activities in Ohio that contribute to production or gross income for a company whether or not the company has a physical presence in or nexus within the state. Our complaint asked for a judgment declaring the tax unconstitutional and for an injunction preventing any enforcement of the tax. The defendants moved to dismiss the case. On July 28, 2009, the trial court ruled that there was no justiciable controversy in the case, as we had not yet been assessed a tax, and it granted the defendants motions to dismiss. In September 2009, we received a letter of determination from the Ohio Department of Taxation noting the Department s determination

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that we are required to register for remitting of the Commercial Activity Tax, and owe $612,784 in taxes, interest, and penalties as of June 30, 2009. The Ohio Department of Taxation issued additional estimated assessments of estimated tax, interest and penalties totaling $121,958 as of December 31, 2011.We have filed protests to challenge the Department s Assessments on constitutional grounds and the matter is currently pending before the Ohio Department of Taxation s Legal Division for administrative review and determination. A hearing on these matters was held November 18, 2011. No administrative ruling has been issued following the hearing. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We believe the determinations to be unlawful and erroneous and are vigorously contesting the determination.

On March 10, 2009, we were sued in a class action filed in the United States District Court, Eastern District of New York. Cynthia Hines, the nominative plaintiff on behalf of herself and others similarly situated, seeks damages under claims for breach of contract, common law fraud and New York consumer fraud laws. The Plaintiff alleges we failed to properly disclose our returns policy to her and that we improperly imposed a restocking charge on her return of a vacuum cleaner. We filed a motion to dismiss based upon assertions that our agreement with our customers requires all such actions to be arbitrated in Salt Lake City, Utah. Alternatively, we asked that the case be transferred to the United States District Court for the District of Utah, so that arbitration may be compelled in that district. On September 8, 2009 the motion to dismiss or transfer was denied, the court stating that our browsewrap agreement was insufficient under New York law to establish an agreement with the customer to arbitrate disputes in Utah. On October 8, 2009, we filed a Notice of Appeal of the court s ruling. The appeal was denied. On December 31, 2010 Hines filed an amended complaint. The amended complaint eliminated common law fraud claims and breach of contract claims and added claims for breach of Utah s consumer protection statute and various other state consumer protection statutes. The amended complaint also asks for an injunction. The suit is in final discovery stages. We filed motions to dismiss and to decertify the class. The court has not ruled on these motions. 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.

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 in this action. On November 11, 2009, the parties stipulated to stay all proceedings in the case until resolution of a the United States Patent and Trademark Office had concluded and resolved a reexamination of the patent in question, and also until a previously filed infringement action against Wal-Mart Stores, Inc. and other retailers resulted either in judgment or dismissal. Subsequently, the parties agreed to extend the time for defendants complaint answer until 21 days following a court order to lift the stay to which the parties stipulated. The United States Patent and Trademark Office resolved the reexamination of the patent in question in favor of SpeedTrack, Inc. The case remains stayed, pending the outcome of the infringement action against Wal-Mart Stores, Inc. and other retailers. On February 22, 2012, the court in the Wal-Mart Stores case granted Wal-Mart Stores motion for summary judgment of non-infringement. The court also granted Speedtrack s motion for summary judgment on patent validity. It is not known whether the summary judgments granted in the Wal-Mart Stores case will have an effect on the Speedtrack case in which we are named as one of the defendants. 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 or about September 25, 2009, Alcatel-Lucent USA, Inc. filed suit against us and 12 other defendants in the United States District Court in the Eastern District of Texas. We are alleged to have infringed three patents purportedly related to a communications protocol between a user and server terminals, text input functionalities and search processes. We believe a third party vendor of search products and services sold to us is contractually obligated to indemnify us in this action as it pertains to the search patent. On October 14, 2011, a jury returned a verdict in our favor, finding non-infringement on all asserted claims, on all patents, and finding of invalidity of the Alcatel-Lucent patent, having to do with a communications protocol. On November 29, 2011, Alcatel-Lucent filed a motion for a new trial which was denied. Alcatel-Lucent has filed an appeal which we will oppose.

On May 11, 2010, Site Update Solutions, LLC filed suit against us and 34 other defendants in the United States District Court in the Eastern District of Texas (now transferred to the Northern District of California) for infringement of a patent claiming a process for maintaining ongoing registration for pages on a given search engine . . . a method to actively cause an updating of a specific Internet search engine database regarding

a particular WWW resource.   The case was later transferred to the Northern District of California where, following an adverse ruling, Site Update Solutions agreed to dismiss the case and on August 13, the court entered its order of dismissal.

On September 29, 2010, a trustee in bankruptcy filed against us an adversary proceeding 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 trustee does not specify a date for the transactions; however we believe that any alleged transaction with the Petters Company would have taken place in excess of seven years from the date of the filing of the adversary proceeding. The case is in its early stages. We filed a motion to dismiss on statute of limitations and other grounds. The court has not ruled upon the motion to dismiss. The nature of the loss contingencies relating to claims that have been asserted against us are

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described above. However, no estimate of the loss or range of loss can be made. 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 recently joined the suit. These district attorneys seek 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 asks for damages in the amount of not less than $15 million. The suit is in the discovery stage. 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 September 11, 2011, Droplets, Inc. filed suit against us and eight other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering strings of programming code downloaded from a server to a client computer. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 13, 2011, Select Retrieval, LLC filed suit against us and 79 other defendants in the United States District Court for the District of Delaware for infringement of a patent covering the hierarchical display of interactive links on a webpage. We filed a motion to dismiss which was denied. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On November 18, 2011 Smartfit Solutions, LLC filed suit against us and 43 other defendants in the United States District Court for the Eastern District of Texas for infringement of a patent covering certain methods for presenting exercise protocols to a user and evaluating the effectiveness of the same. We have tendered the defense of this action to an indemnitor which has accepted the defense. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On December 29, 2011 The Tobin Family Education and Health Foundation filed suit against us in the United States District Court for the District of New Jersey for infringement of a patent covering a method and system for customizing marketing services on networks communication with hypertext tagging conventions. We have tendered the defense of this action to an indemnitor which has accepted the defense and settled the case at no cost to us. On July 13, 2012, the court accepted the settlement and entered an order dismissing us from the case.

On January 27, 2012, Pragmatus Telecom, LLC filed suit against us in the United States District Court for the District of Delaware for infringement of two patents covering a system for coordinating data and voice communications via customer contact channel changing system using voice over IP and infringement of one patent for coordinating data and voice communications via customer contact channel changing system. We have answered the complaint. We have tendered the defense of the case to an indemnitor, who has moved to stay the case against us pending the disposition of a declaratory action which the indemnitor brought against Pragmatus Telecom. The case against us was stayed July 10, 2012, pending resolution of the declaratory action. 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 March 1, 2012, H-W Technology, L.C. filed suit against us in the United States District Court in the Northern District of Texas for infringement of a patent entitled Internet Protocol (IP) Phone with Search and Advertising Capability. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights, if any, with our vendors.

On May 2, 2012, Execware LLC filed suit against us in the United States District Court for the District of Delaware for infringement of a patent entitled: Integrated Dialog Box for Rapidly Altering Presentation of Parametric Text Data Objects on a Computer Display. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On May 10, 2012, Lodsys Group, LLC filed suit against us and seven other defendants in the United States District Court for the Eastern District of Texas for infringement of a patent covering method and system for gathering information from units of a commodity across a network. We have tendered the defense of this action to an indemnitor which has accepted the defense. We have not answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

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On July 16, 2012, Digitech Image Technologies, LLC filed against us and forty-five other defendants in the United States District Court for the Central District of California for infringement of a patent covering the imaging technology that facilitates prediction of color and location within digital cameras. We have tendered defense of the case to an indemnitor which has accepted the defense. Following an adverse ruling in the case, the case was dismissed and in September 2012, Digitech filed a new complaint in the same court on the same infringement claims. In the new action, our indemnitor continues to defend the case. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On July 19, 2012, Data Carriers, LLC filed suit against us in the United States District Court for the District of Delaware for infringement of a patent covering the autocomplete features of our website. We believe a third party vendor is contractually obligated to indemnify us in this action. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On October 18, 2012 ArrivalStar and Melvino Technologies Limited, filed suit against us in the United States District Court for the Southern District of Florida for infringement of three patents, described in summary as follows: (1) System and Method for Activation of an Advance Notification for Monitoring and Reporting Status of Vehicle Travel; (2) System and Method for Advance Notification System for Monitoring and Reporting Proximity of a Vehicle; and (3) Notification System and Methods with User-Defineable Notifications Based Upon Occurrence of Events. The complaint has not yet been served. 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, if any, with our vendors.

We establish liabilities when a particular contingency is probable and estimable. As of September 30, 2012, we have accrued $3.0 million in light of these 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, 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.

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.

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Stock options	$	$ 13	$ 3	$ 194
Restricted stock awards	980	688	2,621	2,217
Total stock-based compensation expense	$ 980	$ 701	$ 2,624	$ 2,411

Restricted stock awards

During the three and nine months ended September 30, 2012, the Compensation Committee of the Board of Directors approved grants of 1,500 and 795,000 restricted stock awards to our officers, board members and employees, for the respective periods. The restricted stock awards vest over three years at 25% at the end of the first year, 25% at the end of the second year and 50% at the end of

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the third year and are subject to the employee s continuing service to us. At September 30, 2012, there were 1,037,000 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 recognized on a straight line basis over the three-year vesting schedule. The weighted average grant date fair value of restricted stock awards granted during the three and nine months ended September 30, 2012 was $7.79 and $6.75, respectively.

The following table summarizes restricted stock award activity during the nine months ended September 30, 2012 (in thousands):

	Nine months ended September 30, 2012		
	Units		Weighted Average Grant Date Fair Value
Outstanding beginning of year	522	$	13.40
Granted at fair value	795		6.75
Vested	(236)		12.06
Forfeited	(44)		8.71
Outstanding end of period	1,037	$	8.80

8. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 *Segment Reporting*. Segments were determined based on products and services provided by each segment. There were no inter-segment sales or transfers during the three and nine months ended September 30, 2012 and 2011. We evaluate the performance of our segments and allocate resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three and nine months ended September 30, 2012 and 2011 (in thousands):

	Three months ended September 30,						Nine months ended September 30,					
		Direct		Fulfillment partner		Total		Direct		Fulfillment partner		Total
2012												
Revenue, net	$	34,215	$	221,137	$	255,352	$	109,048	$	648,207	$	757,255
Cost of goods sold		30,684		178,126		208,810		99,422		520,614		620,036
Gross profit	$	3,531	$	43,011	$	46,542	$	9,626	$	127,593	$	137,219
Operating expenses						(44,767)						(132,950)
Other income (expense), net						1,049						1,795
Provision for income taxes						131						182
Net income					$	2,693					$	5,882
2011												
Revenue, net	$	34,749	$	204,989	$	239,738	$	116,353	$	623,847	$	740,200
Cost of goods sold		32,472		168,893		201,365		105,733		506,240		611,973
Gross profit	$	2,277	$	36,096	$	38,373	$	10,620	$	117,607	$	128,227

Operating expenses		(46,314)		(143,573)
Other income (expense), net		(86)		(885)
Benefit for income taxes		(240)		(202)
Net loss	$	(7,787)	$	(16,029)

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

The fulfillment partner segment includes revenues, direct costs and cost allocations associated with sales of merchandise of third parties over our Website, fulfilled from warehouses maintained by our fulfillment partners. Costs for this segment include product

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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, 2012 and 2011, over 99% of sales were made to customers in the United States. At September 30, 2012 and December 31, 2011, all of our fixed assets were located in the United States.

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

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents incorporated herein by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements involve risks and uncertainties, and relate to future events or our future financial or operating performance. 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 ability to attract and retain customers in a cost-efficient manner;*
- *the effectiveness of our marketing;*
- *our future operating and financial results;*
- *the competition we face and will face in our business;*
- *the effects of government regulation;*
- *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 our debt;*
- *our plans for international markets;*
- *our plans for changes to our business;*
- *our beliefs regarding current or future litigation or regulatory actions;*
- *our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business;*
- *our beliefs regarding the adequacy of our insurance coverage;*
- *the adequacy of our infrastructure, including our backup facilities and our disaster planning;*
- *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;*
- *our beliefs regarding the adequacy of our customer service capabilities;*
- *our beliefs and expectations regarding the adequacy of our office and warehouse facilities;*
- *our expectations regarding our travel shopping service, our insurance shopping service, our international sales efforts, our car listing service and our community site, and the anticipated functionality and results of operations of any of them;*
- *our belief that we and our fulfillment 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 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.*

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

- *changes in U.S. and global economic conditions and consumer spending;*
- *world events;*
- *the rate of growth of the Internet and online commerce;*
- *any failure to maintain our existing relationships or build new relationships with fulfillment 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;*
- *modifications we may make to our business model from time to time, including aspects relating to our product mix and the mix of direct/fulfillment partner sourcing of the products we offer;*
- *the mix of products purchased by our customers;*
- *problems with cyber security or data breaches;*
- *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;*
- *problems with 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 fraudulent purchases;*
- *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 expansion with either internally generated funds or external sources of financing;*
- *the extent to which we owe income taxes or are required to collect sales taxes or to modify our business model in order to avoid being required to collect sales taxes;*
- *competition;*
- *management of growth;*
- *fluctuations in our operating results;*
- *our efforts to expand internationally;*
- *the outcomes of legal proceedings;*
- *investigations and claims;*
- *optimization of our warehouse operations;*
- *risks of inventory management and seasonality.*

In evaluating all forward-looking statements, you should specifically consider the risks outlined above and those described in Item 1A under the caption Risk Factors. These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Except as otherwise required by law, we expressly disclaim any obligation to release publicly any update or revisions to any forward-looking statements to reflect any changes in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

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

Available Information

Our Internet Website addresses are www.overstock.com, www.o.co and www.o.biz. 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 our Internet Website 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 discount brand name, non-brand name and closeout merchandise, including bed-and-bath goods, home décor, kitchenware, furniture, watches and jewelry, apparel, electronics and computers, sporting goods, and designer accessories, among other products. We sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games (BMMG). We are also a channel through which customers can purchase cars, insurance and travel products, services and we sell advertising. We sell these products and services through our Internet websites located at www.overstock.com, www.o.co and www.o.biz (Website) and also through other ecommerce marketplace websites. Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the three websites and the process of order fulfillment described herein are the same for all three websites.

Our company, based in Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999. Our Website offers our customers an opportunity to shop for bargains conveniently, while offering our suppliers an alternative inventory liquidation or sales channel. We continually add new, sometimes limited, inventory products to our Website in order to create an atmosphere that encourages customers to visit frequently and purchase products before our inventory sells out. We sell products primarily in the United States, with a small amount of products (less than 1% of sales) sold internationally.

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

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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 the Special Note Regarding Forward-Looking Statements at the beginning of Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Net income was $2.7 million in Q3 2012 versus a net loss of $7.8 million in Q3 2011. The $10.5 million year-over-year improvement in net income resulted primarily from revenue growth of 7%, a 220 basis point improvement in gross margin (taken together, leading to a $8.2 million increase in gross profit), and $2.3 million lower expenses.

Revenues in Q3 2012 increased 7% compared to Q3 2011. We continued to see an increase in the number of unique visitors to our website and average order size. These increases more than offset the impact of fewer customer orders due to lower conversion rates. Gross profit increased 21% compared to Q3 2011 primarily as a result of 7% revenue growth and a 220 basis point expansion in gross margin. Sales and marketing expenses remained flat at 5.8% of revenue in Q3 2012 compared to Q3 2011. As a result, we had a 29% increase in Contribution (see Non-GAAP Financial Measures below for a reconciliation of Contribution to Gross Profit) compared to Q3 2011. Contribution margin was 12.4%.

Technology expense in Q3 2012 decreased $1.1 million compared to Q3 2011, primarily due to decreases in compensation and recruiting-related costs largely associated with our lower technology headcount. General and administrative expenses in Q3 2012 decreased $1.5 million compared to Q3 2011, primarily due to a decrease in legal fees, partially offset by an increase in compensation related costs largely due to an increase in bonus expense.

Our fulfillment partner business continues to make up a large percentage of our total revenues, expanding to nearly 87% of total revenue in Q3 2012. As a result, we are converting revenues into cash on average nearly seven days before we pay our suppliers. This has reduced the capital requirements needed to operate our business, and has consistently helped us to generate positive operating cash flows on a trailing twelve month basis for the past several years. Our working capital improved from $(14.1) million at December 31, 2011 to $(4.5) million at September 30, 2012.

Our Financing Agreement with U.S. Bank expires on December 31, 2012. We do not anticipate entering into a new agreement with U.S. Bank. As a result, we expect to repay the $17 million that is currently outstanding from our operating cash by December 31, 2012.

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,		Nine months ended September 30,	
	2012	2011	2012	2011
	(as a percentage of total net revenue)			
Revenue, net				
Direct	13.4%	14.5%	14.4%	15.7%
Fulfillment partner	86.6	85.5	85.6	84.3
Total net revenue	100.0	100.0	100.0	100.0
Cost of goods sold				
Direct	12.0	13.5	13.1	14.3
Fulfillment partner	69.8	70.5	68.8	68.4
Total cost of goods sold	81.8	84.0	81.9	82.7
Gross profit	18.2	16.0	18.1	17.3
Operating expenses:				
Sales and marketing	5.8	5.8	5.7	5.8
Technology	6.3	7.2	6.2	6.8
General and administrative	5.4	6.4	5.7	6.8
Restructuring				
Total operating expenses	17.5	19.4	17.6	19.4
Operating income (loss)	0.7	(3.4)	0.5	(2.1)
Interest income				
Interest expense	(0.1)	(0.3)	(0.1)	(0.3)
Other income, net	0.5	0.2	0.3	0.1
Net income (loss) before income taxes	1.1	(3.5)	0.7	(2.3)
Provision (benefit) for income taxes	0.1	(0.1)		
Net income (loss)	1.1%	(3.4)%	0.7%	(2.3)%

Comparisons of Three Months Ended September 30, 2012 to Three Months Ended September 30, 2011, and Nine Months Ended September 30, 2012 to Nine Months Ended September 30, 2011.

Revenue

The following table reflects our net revenues for the three and nine months ended September 30, 2012 and 2011 (in thousands):

Revenue, net								
Direct	$ 34,215	$ 34,749	$ (534)	(1.5)%	$ 109,048	$ 116,353	$ (7,305)	(6.3)%

Fulfillment partner		221,137		204,989		16,148	7.9%		648,207		623,847		24,360	3.9%
Total revenue, net	$	255,352	$	239,738	$	15,614	6.5%	$	757,255	$	740,200	$	17,055	2.3%

The primary reasons for increased total net revenue for the three and nine months ended September 30, 2012 were increases in unique visitors and average order size, partially offset by lower conversion rates, resulting in fewer unique customers and orders compared to last year.

The primary reason for decreased direct revenue for the three and nine months ended September 30, 2012 was a shift in sales mix, particularly in clothing and shoes, from a direct inventory-based model to a fulfillment partner-based model to reduce exposure from seasonal inventory and mark downs, partially offset by an increase in sales of home and garden products.

The primary reason for the increase in fulfillment partner revenue for the three and nine months ended September 30, 2012 was an increase in sales of home and garden products.

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The shift of business from direct to fulfillment partner (or vice versa) is an economic decision based on the economics of each particular product offering at the time and we do not have particular goals for appropriate mix or percentages for the size of either. We believe that the mix of the business between direct and fulfillment partner is consistent with our strategic objectives for our business model in the current economic environment and with the exception of a transition of our direct clothing and shoes category to a fulfillment partner model to reduce our seasonal inventory risks, we do not currently foresee any material shifts in mix.

Total revenues from international sales were $2.3 million and $2.2 million for the three months ended September 30, 2012 and 2011, respectively and $6.6 million and $6.2 million for the nine months ended September 30, 2012 and 2011, respectively.

Change in estimate of average transit times (days)

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. 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.

The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and net income for the three months ended September 30, 2012 (in thousands):

	Three months ended September 30, 2012			
Change in the Estimate of Average Transit Times (Days)		**Increase (Decrease) Revenue**		**Increase (Decrease) Net Income**
2	$	(10,911)	$	(1,813)
1	$	(4,887)	$	(792)
As reported		As reported		As reported
-1	$	3,028	$	501
-2	$	5,945	$	977

See Executive Commentary above for additional discussion regarding revenue.

Gross profit and gross margin

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

The following table reflects our net revenues, cost of goods sold and gross profit for the three and nine months ended September 30, 2012 and 2011 (in thousands):

Revenue, net								
Direct	$ 34,215	$ 34,749	$ (534)	(1.5)%	$ 109,048	$ 116,353	$ (7,305)	(6.3)%
Fulfillment partner	221,137	204,989	16,148	7.9%	648,207	623,847	24,360	3.9%
Total net revenues	$ 255,352	$ 239,738	$ 15,614	6.5%	$ 757,255	$ 740,200	$ 17,055	2.3%
Cost of goods sold								
Direct	$ 30,684	$ 32,472	$ (1,788)	(5.5)%	$ 99,422	$ 105,733	$ (6,311)	(6.0)%
Fulfillment partner	178,126	168,893	9,233	5.5%	520,614	506,240	14,374	2.8%
Total cost of goods sold	$ 208,810	$ 201,365	$ 7,445	3.7%	$ 620,036	$ 611,973	$ 8,063	1.3%
Gross Profit								
Direct	$ 3,531	$ 2,277	$ 1,254	55.1%	$ 9,626	$ 10,620	$ (994)	(9.4)%
Fulfillment partner	43,011	36,096	6,915	19.2%	127,593	117,607	9,986	8.5%
Total gross profit	$ 46,542	$ 38,373	$ 8,169	21.3%	$ 137,219	$ 128,227	$ 8,992	7.0%

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Gross margins for the past seven quarterly periods and fiscal year ending 2011 were:

	Q1 2011	Q2 2011	Q3 2011	Q4 2011	FY 2011	Q1 2012	Q2 2012	Q3 2012
Direct	10.7%	9.6%	6.6%	7.0%	8.5%	8.0%	8.3%	10.3%
Fulfillment Partner	20.7%	18.1%	17.6%	17.8%	18.5%	20.0%	19.6%	19.4%
Combined	18.9%	16.9%	16.0%	16.2%	17.0%	18.1%	18.0%	18.2%

The 370 basis point increase in direct gross margin for the three months ended September 30, 2012 when compared to the same period in 2011 is primarily due to pricing initiatives and lower credit card fees, partially offset by higher return-related and freight costs, and increased coupons and promotions. The 30 basis point decrease in direct gross margin for the nine months ended September 30, 2012 when compared to the same period in 2011 is primarily due to higher return-related, freight and warehouse costs, partially offset by pricing initiatives and lower credit card fees.

The 180 and 80 basis point increases in fulfillment partner gross margin for the three and nine months ended September 30, 2012 when compared to the same periods in 2011 are primarily due to a shift in sales mix into higher margin home and garden products, pricing initiatives and lower credit card costs, partially offset by higher return-related and freight costs and increased coupons and promotions.

Cost of goods sold includes stock-based compensation expense of $74,000 and $47,000 for the three months ended September 30, 2012 and 2011, respectively and $200,000 and $134,000 for the nine months ended September 30, 2012 and 2011, respectively.

See Executive Commentary above for additional discussion.

Operating expenses

Sales and marketing expenses

We advertise through a number of targeted online marketing channels, such as sponsored search, affiliate marketing, portal advertising, e-mail campaigns, and other initiatives. We also use nationwide television, print and radio advertising campaigns to promote sales.

The following table reflects our sales and marketing expenses for the three and nine months ended September 30, 2012 and 2011 (in thousands):

Three months ended September 30,	Nine months ended September 30,

	2012	2011	$ Change	% Change	2012	2011	$ Change	% Change
Sales and marketing expenses	$ 14,899	$ 13,822	$ 1,077	7.8%	$ 42,886	$ 42,902	$ (16)	(0.0)%
Sales and marketing expenses as a percent of net revenues	5.8%	5.8%			5.7%	5.8%		

Sales and marketing expenses as a percentage of revenue remained relatively flat for the three and nine months ended September 30, 2012 when compared to the same period in 2011.

Sales and marketing expenses include stock-based compensation expense of $108,000 and $80,000 for the three months ended September 30, 2012 and 2011, respectively and $260,000 and $289,000 for the nine months ended September 30, 2012 and 2011, respectively.

In May 2012, Google, Inc. (Google) announced that it is discontinuing providing its free Google Base product listing service to retailers by the fall of 2012 and offering retailers a new fee based product listing service. Depending on our level of participation in the new program, this change may result in higher advertising expense in the future; however, we cannot determine the impact until we gain experience with Google s new program. We are constantly evaluating the performance of our marketing channels and adjust our advertising expense to optimize performance.

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

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Technology expenses

The following table reflects our technology expenses for the three and nine months ended September 30, 2012 and 2011 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2012	**2011**	**$ Change**	**% Change**	**2012**	**2011**	**$ Change**	**% Change**
Technology expenses	$ 16,085	$ 17,171	$ (1,086)	(6.3)%	$ 46,845	$ 50,639	$ (3,794)	(7.5)%
Technology expenses as a percent of net revenues	6.3%	7.2%			6.2%	6.8%		

The $1.1 million and $3.8 million decreases for the three and nine months ended September 30, 2012, respectively, are primarily due to decreases in compensation and recruiting-related costs primarily from lower headcount.

Technology expenses include stock-based compensation expense of $218,000 and $171,000 for the three months ended September 30, 2012 and 2011, respectively and $585,000 and $534,000 for the nine months ended September 30, 2012 and 2011, respectively.

General and administrative expenses

The following table reflects our general and administrative expenses for the three and nine months ended September 30, 2012 and 2011 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2012	**2011**	**$ Change**	**% Change**	**2012**	**2011**	**$ Change**	**% Change**
General and administrative expenses	$ 13,828	$ 15,321	$ (1,493)	(9.7)%	$ 43,166	$ 50,032	$ (6,866)	(13.7)%
General and administrative expenses as a percent of net revenues	5.4%	6.4%			5.7%	6.8%		

The $1.5 million decrease in general and administrative expenses (G&A) is primarily due to a decrease in legal fees, partially offset by an increase in compensation-related costs primarily due to an increase in bonus expense. The $6.9 million decrease in G&A expenses for the nine months ended September 30, 2012, is primarily due to a decrease in legal fees, travel and office expenses and compensation-related costs

primarily due to lower headcount.

G&A expenses include stock-based compensation expense of approximately $580,000 and $403,000 for the three months ended September 30, 2012 and 2011, respectively, and $1.6 million and $1.5 million for the nine months ended September 30, 2012 and 2011, respectively.

Restructuring

We reversed $45,000 of lease termination costs during the three months ended September 30, 2012 due to changes in our estimate of sublease income as a result of our entering into a new sublease agreement. We incurred $53,000 of lease termination costs during the nine months ended September 30, 2012 due to ceasing the use of some of our office facilities and changes in the estimate of sublease income as a result of our entering into a new sublease agreement. There were no restructuring charges or reversals during the three and nine months ended September 30, 2011.

Depreciation expense

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Cost of goods sold - direct	$ 123	$ 137	$ 350	$ 583
Technology	3,371	3,766	10,570	11,009
General and administrative	345	307	1,015	880
Total depreciation and amortization, including internal-use software and website development	$ 3,839	$ 4,210	$ 11,935	$ 12,472

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Non-operating income (expense)

Interest income

Interest income is primarily derived from the investment of our cash in cash equivalents and short-term investments. Interest income for the three months ended September 30, 2012 and 2011 totaled $30,000 and $23,000, respectively and $86,000 and $121,000 for the nine months ended September 30, 2012 and 2011, respectively.

Interest expense

Interest expense is nearly all related to interest incurred on our Senior Notes, finance obligations, line of credit and our capital leases. Interest expense for the three months ended September 30, 2012 and 2011 totaled $194,000 and $662,000, respectively and $655,000 and $2.0 million for the nine months ended September 30, 2012 and 2011, respectively. The decreases in interest expense are primarily a result of extinguishments of Senior Notes and certain finance obligations, partially offset by increased expense related to our line of credit.

Other income, net

Other income, net for the three months ended September 30, 2012 and 2011 totaled $1.2 million and $553,000, respectively and $2.4 million and $962,000 for the nine months ended September 30, 2012 and 2011, respectively. The increases in other income, net during the three and nine months ended September 30, 2012 are primarily due to increased Club O rewards breakage.

Income taxes

Our provision (benefit) for income taxes for the three months ended September 30, 2012 and 2011 totaled $131,000 and ($240,000), respectively and $182,000 and ($202,000) for the nine months ended September 30, 2012 and 2011, respectively. The provision for income taxes is for alternative minimum tax, state tax payments and certain income tax uncertainties, including penalties and interest.

Seasonality

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect our results of operations

in the future.

The following table reflects our total net revenues for each of the quarters since 2010 (in thousands):

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter
2012	$	262,367	$	239,536	$	255,352	$ N/A
2011	$	265,470	$	234,992	$	239,738	$ 314,077
2010	$	264,330	$	231,253	$	245,420	$ 348,870

Liquidity and Capital Resources

Current sources of liquidity

While we believe that the cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months; we may require additional financing. Our $20 million credit facility with U.S. Bank is scheduled to terminate on December 31, 2012 and we intend to repay and terminate the credit facility at its maturity. While we do not expect to require replacement financing in the near future, we may seek replacement financing. If we do, there can be no assurance that additional financing will be available, or, if available, that such financing can be obtained on satisfactory terms. Failure to generate sufficient revenues, profits or to raise additional capital could have a material adverse effect on our operations and on our ability to achieve our intended business objectives. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

Our principal sources of liquidity are cash flows generated from operations, and our existing cash and cash equivalents. At September 30, 2012, our cash and cash equivalents balance was $72.5 million.

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Cash flow information is as follows:

	Nine months ended September 30,		Twelve months ended September 30,	
	2012	2011	2012	2011
Cash provided by (used in):				
Operating activities	$ (13,337)	$ (16,300)	$ 28,626	$ 31,744
Investing activities	(10,428)	(6,470)	(12,863)	(7,716)
Financing activities	(751)	(22,113)	(22,432)	(21,298)

Free Cash Flow.

Free Cash Flow (a non-GAAP measure) for the nine months ended September 30, 2012 and 2011, was $(23.9) million and $(22.6) million, respectively and $15.7 million and $24.2 million for the twelve months ended September 30, 2012 and 2011, respectively. See Non-GAAP Financial Measures below for a reconciliation of Free Cash Flow to net cash provided by (used in) operating activities.

Cash flows from operating activities.

For the nine months ended September 30, 2012 and 2011, our operating activities resulted in net cash outflows of $13.3 million and $16.3 million, respectively.

Cash received from customers generally corresponds to our net revenues as our customers primarily use credit cards to buy from us causing our receivables from these sales transactions to settle quickly. We have payment terms with our fulfillment partners that generally extend beyond the amount of time necessary to collect proceeds from our customers. As a result, following our typically seasonally strong fourth quarter sales, at December 31 of each year, our cash, cash equivalents and accounts payable balances normally reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). However, our accounts payable balance normally declines during the first three months following year-end, which normally results in a decline in our cash and cash equivalents balances from the year-end balance. The seasonality of our business causes payables and accruals to grow significantly in the fourth quarter, and then decrease in the first quarter when they are paid.

The $13.3 million of net cash used in operating activities during the nine months ended September 30, 2012 was primarily for payments of accounts payable of $27.0 million following the holiday season and a decrease in accrued liabilities of $7.5 million, partially offset by non-cash depreciation, amortization and stock compensation expense of $14.6 million and net income of $5.9 million.

The $16.3 million of net cash used in operating activities during the nine months ended September 30, 2011 was primarily for payments of accounts payable of $24.8 million following the holiday season, a net loss of $16.0 million, a decrease in accrued liabilities of $3.5 million, an increase of $3.2 million in prepaid and other assets, partially offset by non-cash depreciation, amortization and stock compensation expense of $14.9 million, a decrease of $12.9 million in inventories and a reduction in accounts receivable of $5.1 million.

Cash flows from investing activities.

For the nine months ended September 30, 2012 and 2011, investing activities resulted in net cash outflows of $10.4 million and $6.5 million, respectively, resulting primarily from expenditures for fixed assets.

Cash flows from financing activities.

For the nine months ended September 30, 2012 and 2011, financing activities resulted in net cash outflows of $751,000 and $22.1 million, respectively.

The $751,000 used in financing activities during the nine months ended September 30, 2012 resulted primarily from $464,000 for the purchase of shares of our common stock withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants.

The $22.1 million used in financing activities during the nine months ended September 30, 2011 resulted primarily from $34.6 million used for retirement of long-term debt, $3.4 million in payments on finance obligations and $1.6 million for the purchase of shares of our common stock withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants, partially offset by $17.0 million in proceeds from drawdown on a line of credit.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of September 30, 2012 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):

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	Payments Due by Period						
Contractual Obligations	Remainder of 2012	2013	2014	2015	2016	Thereafter	Total
Line of credit	17,000						17,000
Interest on line of credit	117						117
Operating leases	2,033	8,206	8,404	6,814	1,381	183	27,021
Naming rights		1,273	1,311	1,351	1,391		5,326
Purchase obligations	16,657	3,262					19,919
Total contractual cash obligations	$ 35,807	$ 12,741	$ 9,715	$ 8,165	$ 2,772	$ 183	$ 69,383

	Amounts of Commitment Expiration Per Period						
Other Commercial Commitments	2012	2013	2014	2015	2016	Thereafter	Total
Letters of credit	$ 1,890	$	$	$	$	$	$ 1,890

Naming Rights

During 2011, we entered into a six-year agreement with the Oakland-Alameda County Coliseum Authority (OACCA) for the right to name Oakland Alameda County Coliseum. Amounts represent annual payments due OACCA for the naming rights and we may terminate this agreement at our sole option, subject to its termination fee.

Purchase obligations

The amount of purchase obligations shown above is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at September 30, 2012. Under different assumptions regarding our rights to cancel our purchase orders or different assumptions regarding the enforceability of the purchase orders under applicable law, the amount of purchase obligations shown in the table above would be less.

Tax Contingencies

Our contractual obligations presented above exclude unrecognized tax contingencies, including interest and penalties, of $326,000 for which we cannot make a reasonably reliable estimate of the amount and period of payment.

Recommendation Algorithm Development Costs

During 2011, we announced two contests offering cash prizes of up to $1.3 million for each contest period to the researcher or research team who can design and develop a recommendation algorithm which provides a minimum 1% increase in sales as compared to our existing algorithm. In June 2012, we announced that the Peer Review Committee determined that there were no qualifying entries and that the contests had been concluded with no prizes awarded.

Borrowings

U.S. Bank Financing Agreements

We are a party to a Financing Agreement with U.S. Bank National Association (U.S. Bank) dated December 22, 2009 (as amended to date, the Financing Agreement). The maximum credit potentially available under the revolving facility is $20 million. Our obligations under the Financing Agreement and all related agreements are secured by all or substantially all of our assets, excluding our interest in certain litigation. Subject to certain exceptions, the full amount of the revolving facility is expected to be available to us as long as $20 million in the aggregate is maintained on deposit with U.S. Bank. At September 30, 2012 and at the date of this report we maintain $20 million on deposit with U.S. Bank. The obligation of U.S. Bank to make advances under the Financing Agreement is subject to the conditions set forth in the Financing Agreement.

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

The stated termination date of the Financing Agreement is December 31, 2012. The maximum amount potentially available under the Financing Agreement is $20 million, limited to $3 million for cash-collateralized letters of credit and other financial accommodations, and $17 million for advances supported by our non-cash collateral.

Advances under the Financing Agreement bear interest at one-month LIBOR plus 2.5%. The interest rate for borrowings under the Financing Agreement was 2.75% at September 30, 2012. We have also entered into an interest rate cap agreement with U.S. Bank with an effective date of October 1, 2011 limiting our exposure for one-month LIBOR at 0.5% for the term of the Financing Agreement.

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

Amounts outstanding under the Financing Agreement were $17.0 million at September 30, 2012 and December 31, 2011, and letters of credit totaling $1.9 million and $2.0 million, respectively, 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. At September 30, 2012, we had $20.0 million in compensating cash balances held at U.S. Bank. If we draw on the $20.0 million compensating cash balance, it will constitute a triggering event and result in additional and more restrictive covenants.

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, 2012, $2.2 million was outstanding and $2.8 million was available under the Purchasing Card. At December 31, 2011, $3.4 million was outstanding and $1.6 million was available under the Purchasing Card.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

The preparation of our financial statements requires that we make estimates and judgments. We base these on historical experience and on other assumptions that we believe to be reasonable. Our critical accounting policies are discussed in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K, for the year ended December 31, 2011. There have been no material changes to the critical accounting policies previously disclosed in that report.

Non-GAAP Financial Measures

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

Contribution and Contribution Margin.

Contribution (a non-GAAP financial measure) (which we reconcile to Gross profit in our statement of operations) consists of gross profit less sales and marketing expense and reflects an additional way of viewing our results. Contribution Margin is Contribution as a percentage of revenues. When viewed with our GAAP gross profit less sales and marketing expenses, we believe Contribution and Contribution margin provides management and users of the financial statements information about our ability to cover our fixed operating costs, such as technology and general and administrative expenses. Contribution and Contribution Margin are used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial

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measures. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure. The material limitation associated with the use of Contribution is that it is an incomplete measure of profitability as it does not include all operating expenses or non-operating income and expenses. Management compensates for these limitations when using this measure by looking at other GAAP measures, such as operating income (loss) and net income (loss).

For further details on Contribution and Contribution Margin, see the calculation of these non-GAAP financial measures below (in thousands):

Total net revenue	$ 255,352	100%	$ 239,738	100%	$ 757,255	100%	$ 740,200	100%
Cost of goods sold	208,810	81.8%	201,365	84.0%	620,036	81.9%	611,973	82.7%
Gross profit	46,542	18.2%	38,373	16.0%	137,219	18.1%	128,227	17.3%
Less: Sales and marketing expense	14,899	5.8%	13,822	5.8%	42,886	5.7%	42,902	5.8%
Contribution and contribution margin	$ 31,643	12.4%	$ 24,551	10.2%	$ 94,333	12.5%	$ 85,325	11.5%

Free Cash Flow.

Free cash flow (a non-GAAP financial measure) reflects an additional way of viewing our cash flows and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows and liquidity. Free cash flow, which we reconcile to Net cash provided by (used in) operating activities , is cash flows from operations reduced by Expenditures for fixed assets, including internal-use software and website development. We believe that cash flows from operating activities is an important measure, since it includes both the cash impact of the continuing operations of the business and changes in the balance sheet that impact cash. However, we believe free cash flow is a useful measure to evaluate our business since purchases of fixed assets are a necessary component of ongoing operations and free cash flow measures the amount of cash we have available for mandatory debt service and financing obligations, changes in our capital structure, and future investments after we have paid our operating expenses. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows as calculated below (in thousands):

	Nine months ended September 30,		**Twelve months ended September 30,**	
	2012	**2011**	**2012**	**2011**
Net cash provided by (used in) operating activities	$ (13,337)	$ (16,300)	$ 28,626	$ 31,744
Expenditures for fixed assets, including internal-use software and website development	(10,563)	(6,344)	(12,960)	(7,538)
Free cash flow	$ (23,900)	$ (22,644)	$ 15,666	$ 24,206

Government Regulation

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

New disclosure and reporting requirements, established under existing or new state or federal laws, such as regulatory rules regarding requirements to disclose efforts to identify the origin and existence of certain conflict minerals or abusive labor practices in portions of our supply chain, could increase the cost of doing business, adversely affecting our results of operations.

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

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any past failures to comply with these requirements.

Factors that May Affect Future Results

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described in this Form 10-Q, and all other information in this Form 10-Q and in our other filings with the SEC including those we file after we file this Form 10-Q, before deciding whether to purchase or hold our securities.

Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in Item 1A under the caption Risk Factors could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not use derivative financial instruments in our investment portfolio, except for an interest rate cap agreement on our line of credit, and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents, marketable securities, trade accounts receivable, accounts payable and long-term obligations. We consider investments in highly-liquid instruments with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents.

Our exposure to market risk for changes in interest rates relates primarily to our short-term investments and short-term obligations; thus, fluctuations in interest rates would not have a material impact on the fair value of these securities. However, the fair values of our investments may be subject to fluctuations due to volatility of the stock market in general, investment-specific circumstances, and changes in general economic conditions.

At September 30, 2012, we had $74.5 million in cash and cash equivalents including restricted cash. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of $745,000 on our earnings or loss, or the fair market value or cash flows of these instruments.

At September 30, 2012, we had $17.0 million outstanding under our short-term debt, and letters of credit totaling $1.9 million were outstanding under our credit facilities. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of $189,000 on our earnings or loss, or the fair market value or cash flows of these instruments. We have entered into an interest rate cap agreement with U.S. Bank with an effective date of October 1, 2011 limiting our exposure for one-month LIBOR at 0.5% for the term of the Financing Agreement.

ITEM 4. CONTROLS AND PROCEDURES

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

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by the Securities Exchange Act of 1934 (the 1934 Act), under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the 1934 Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

During the most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any

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control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under Item 1 of Part I, Financial Statements Note 5 Commitments and Contingencies, subheading Legal Proceedings, contained in the Notes to Consolidated Financial Statements of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this Item.

ITEM 1A. RISK FACTORS

Please consider the following risk factors carefully. If any one of the following risks were to occur, our business, prospects, financial condition and results of operations could be materially adversely affected, and the market price of our securities could decrease. These are not the only risks we face. In addition, the global economic climate amplifies many of these risks.

Existing or future government regulation could harm our business.

We are subject to the same federal, state and local laws as other companies conducting business on the Internet or through other means. Although there are relatively few laws specifically directed at Internet businesses, the number of such laws is increasing and many additional laws and regulations relating to the Internet and commerce by other means are being debated at the state and federal levels. These laws and regulations cover issues such as user privacy, behavioral advertising, auto-renewability of contract, freedom of expression, pricing, fraud, mandated disclosures concerning foreign manufacturer working conditions, electronic waste, mobile and electronic device communications, quality of products and services, taxation, advertising, intellectual property rights and information security. The expansion of these laws, both in terms of their number and their applicability to the Internet could also harm our business. Many laws, adopted prior to the advent of the Internet, do not contemplate or address the unique issues raised thereby. Consequently, courts or regulators may apply these laws to internet commerce in ways that may present difficult or impossible compliance challenges.. Many of those laws that do reference the Internet are still being interpreted by the courts and their applicability and reach are therefore uncertain. Moreover, Internet advances and innovations may result in new questions about the applicability and reach of these laws. Additionally, laws governing the permissible contents of products may adversely affect us, and we are subject to federal and state consumer laws, including those governing advertising, product labeling, product content requirements and product safety, and mandated website disclosures about programs to eliminate abusive labor practices in our supply chain. The laws not only apply to future manufacture of consumer product, but also apply to existing inventories and may cause us to incur losses for any non-compliant items in our inventory, or which we may have sold which may subject us to regulatory or civil actions. Some of the products we sell or manufacture may, under statutory or common law, from time to time expose us to claims related to personal injury, death, environmental or property damage and may from time to time require product recalls or other actions which may not be covered, in whole or in part, by our liability insurance. These current and future laws and regulations could harm our business, prospects, financial condition and results of operation.

General economic factors may adversely affect our financial performance.

General economic conditions may adversely affect our financial performance. In the United States, changes in interest rates, changes in fuel and other energy costs, weakness in the housing market, inflation or deflation or expectations of either inflation or deflation, higher levels of unemployment, unavailability or limitations of consumer credit, higher consumer debt levels or efforts by consumers to reduce debt levels, higher tax rates and other changes in tax laws, overall economic slowdown, changes in consumer desires affecting demand for the products and services we sell and other economic factors could adversely affect consumer demand for the products and services we sell, change the mix of products we sell to a mix with a lower average gross margin and result in slower inventory turnover and greater markdowns on inventory. Higher interest rates, transportation costs, inflation, higher costs of labor, insurance and healthcare, foreign exchange rates fluctuations, higher tax rates and other changes in tax laws, changes in other laws and regulations and other economic factors in the United States can increase our cost of sales and operating, selling, general and administrative expenses, and otherwise adversely affect our operations and operating results. These factors affect not only our operations, but also the operations of suppliers from whom we purchase goods, a condition that can result in an increase in the cost to us of the goods and services we sell.

Decreases in discretionary consumer spending may have an adverse effect on us.

A substantial portion of the products and services we offer are products or services that consumers may view as discretionary

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items rather than necessities. As a result, our results of operations are sensitive to changes in macro-economic conditions that impact consumer spending, including discretionary spending. Difficult macro-economic conditions, particularly high levels of unemployment, also impact our customers ability to obtain consumer credit. Other factors, including consumer confidence, employment levels, interest rates, tax rates, consumer debt levels, and fuel and energy costs could reduce consumer spending or change consumer purchasing habits. A continued slowdown in the U.S. or global economy, or an uncertain economic outlook, could materially adversely affect consumer spending habits and our operating results.

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

We have a history of losses and we may incur operating and net losses in the foreseeable future. As of September 30, 2012, our accumulated deficit was $256 million. We need to generate significant revenues to maintain profitability, and we may not be able to do so. Although we had net income of $13.9 million and $7.7 million in 2010 and 2009, respectively, we incurred a net loss of $19.4 million in 2011. We may not be able to achieve profitability on a quarterly or annual basis in the future. If our revenues grow more slowly than we anticipate or decline, or if our expenses exceed our expectations, our financial results would be harmed and our business, prospects, financial condition and results of operations could fall below the expectations of public market analysts and investors.

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

- further enhance our distribution and order fulfillment capabilities;
- further improve our order processing systems and capabilities;
- develop enhanced technologies and features;
- continue to expand our customer service capabilities to better serve our customers needs;
- expand or modify our product offerings;
- increase our general and administrative functions to support our operations and activities; and
- maintain or increase our sales, branding and marketing activities, including maintaining existing or entering into new online marketing or marketing analytics arrangements, and continuing or increasing our national television and radio advertising, direct mail and/or other marketing campaigns.

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

We may need to implement additional finance and accounting systems, procedures and controls as we grow our business and organization and to satisfy new reporting requirements.

We are required to comply with a variety of reporting, accounting and other rules and regulations. Compliance with existing requirements is expensive. Further requirements may increase our costs and require additional management time and resources. We may need to implement additional finance and accounting systems, procedures and controls to satisfy our reporting requirements. If our internal control over financial reporting is determined to be ineffective, such failure could cause investors to lose confidence in our reported financial information, negatively affect the market price of our common stock, subject us to regulatory investigations and penalties, and adversely impact our business and financial condition.

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial results.

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including but not limited to, revenue recognition, estimating valuation allowances and accrued liabilities (specifically, the allowances for returns, credit card chargebacks, doubtful accounts and obsolete and damaged inventory), internal use software and website development (acquired and developed internally), accounting for income taxes, valuation of long-lived and intangible assets and goodwill, stock-based compensation, and loss contingencies are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance.

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Our cash, cash equivalents, investments in precious metals and short-term investments are subject to a risk of loss based upon the solvency of the financial institutions in which they are maintained and movement in the precious metals markets.

We maintain the majority of our cash, cash equivalents, investments in precious metals, and short-term investments in accounts with major financial institutions within the United States, in the form of demand deposits, money market accounts, time deposits, U.S. Treasury Bills and other short-term investments. Our deposits in these institutions may generally exceed the amounts of insurance provided, or deposits may not at all be covered by insurance. If any of these institutions becomes insolvent, or there is a significant decline in the price of precious metals, it could substantially harm our financial condition and we may lose some, or all, of such deposits.

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

The rapidly evolving nature of our industry and the constantly evolving nature of our business, make forecasting operating results difficult. Since 2005, we have completed several large, complex and expensive infrastructure upgrades in order to increase our ability to handle larger volumes of sales and to develop or increase our ability to perform a variety of analytical procedures relating to our business, and we are continuing the work to upgrade and further expand these and other components of our infrastructure. In the past, we have experienced difficulties with the implementation of various aspects of the upgrades of our infrastructure, and have incurred increased expenses as a result of these difficulties. As a result of these expenditures, our ability to reduce spending if our revenues are lower than we project is limited. Therefore, any significant shortfall in the revenues for which we have built and are continuing to build our infrastructure would likely harm our business, prospects, financial condition and results of operations and cause our results of operation to fall below the expectations of public market analysts and investors.

The seasonality of our business places increased strain on our operations.

A disproportionate amount of our sales normally occur during our fourth quarter. If we do not stock or restock popular products in sufficient amounts to meet customer demand, this could significantly affect our revenue and our future growth. If we liquidate products, as we have in the past, we may be required to take significant inventory markdowns or write-offs, which could reduce gross profits. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. If too many customers access our Website within a short period of time due to increased holiday demand, we may experience system interruptions that make our Website unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. In addition, we may be unable to adequately staff our fulfillment and customer service centers during these peak periods and delivery and other fulfillment companies and customer service co-sourcers may be unable to meet the seasonal demand.

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

At September 30, 2012, we had relationships with approximately 2,100 independent fulfillment partners whose products we offer for sale on our Website. We depend on our fulfillment partners to provide a large portion of the product selection we offer, as these products accounted for 86%

of our net revenues for the nine months ended September 30, 2012. We may expand the number of fulfillment partner relationships and the number of products offered for sale by our fulfillment partners on our Website. If we do not maintain our existing relationships or build new relationships with fulfillment partners on acceptable commercial terms, we may not be able to maintain a broad selection of merchandise, and customers may not shop at or purchase from our Website. In addition, manufacturers may decide not to offer particular products for sale on the Internet or on sites like ours. If we are unable to maintain our existing or build new fulfillment partner relationships or if product manufacturers refuse or restrict sale of their products via the Internet, though sites like ours, or to us, our business and prospects would suffer severely.

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

We do not have any long-term agreements with any of these fulfillment partners. Our agreements with fulfillment partners are terminable at will by either party upon short notice.

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Cyber-attacks affecting our suppliers could adversely affect us

We depend on our fulfillment partners to provide a large portion of the product selection we offer and on vendors for the products we purchase and offer in our direct business. We also depend on suppliers of services which support Website operations, including payment systems, customer service support, and communications. Cyber-attacks affecting any of our most significant suppliers or affecting a significant number of our suppliers of products or services could have adverse effects on our business, prospects, financial condition and results of operations. The adverse effects could include our inability to source product or fulfill orders, our customer customers or suppliers inability to contact us or access our Website or call centers or chat lines, or the compromise of our customers confidential data.

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

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

Risks associated with the suppliers from whom our products are sourced and the safety of those products could adversely affect our financial performance.

The products we sell are sourced from a wide variety of domestic and international suppliers. Global sourcing of many of the products we sell is an important factor in our financial performance. Our ability to find qualified suppliers who meet our standards, and to access products in a timely and efficient manner is a significant challenge, especially with respect to suppliers located and goods sourced outside the United States. Political and economic instability in the countries in which foreign suppliers are located, the financial instability of suppliers, suppliers failure to meet our supplier standards, labor problems experienced by our suppliers, the availability of raw materials to suppliers, merchandise quality issues, currency exchange rates, transport availability and cost, transport security, inflation, and other factors relating to the suppliers and the countries in which they are located are beyond our control. In addition, the United States foreign trade policies, tariffs and other impositions on imported goods, trade sanctions imposed on certain countries, the limitation on the importation of certain types of goods or of goods containing certain materials from other countries and other factors relating to foreign trade are beyond our control. These and other factors affecting our suppliers and our access to products could adversely affect our financial performance.

Our customers count on us to provide them with safe products. Concerns regarding the safety of products that we source from our suppliers and then sell could cause shoppers to avoid purchasing certain products from us, or to seek alternative sources of supply for all of their needs, even if the basis for the concern is outside of our control. Any lost confidence on the part of our customers would be difficult and costly to reestablish. As such, any issue regarding the safety of any items we sell, regardless of the cause, could adversely affect our financial performance.

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

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

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- reduced visibility and accuracy of order status and package tracking;
- delays in order processing and product delivery;
- increased delivery costs, resulting in reduced profit margins; and
- reduced shipment quality, which may result in delivery of damaged products.

Financial performance concerns may cause fulfillment partners or other suppliers to limit or suspend doing business with us, or require prepayments.

We rely upon our fulfillment partners and other suppliers for the product offerings sold on our website and other products and services we use to run our business. Our ability to retain or attract new fulfillment partners and other suppliers may depend in part on our financial performance. Poor financial performance may create concern about our creditworthiness, which could result in suppliers choosing to limit or suspend doing business with us or require us to prepay for our purchases, which could harm our business, prospects, financial condition and results of operations.

We depend upon our credit card processors and payment card associations.

Our customers primarily use credit cards to buy from us. We are dependent upon our credit card processors to process the sales transactions and remit the proceeds to us. The credit card processors have the right to withhold funds otherwise payable to us to establish a reserve based on their assessment of the inherent risks of credit card processing and their assessment of the risks of processing our customers credit cards, and have done so from time to time in the past. The credit card processors may establish, increase or decrease the amount of any reserve at any time. Any increase in the amounts of the reserves established by the processors would have an adverse effect on our cash flow and liquidity, and any material unexpected increase could have a material adverse effect on our business, prospects, financial condition and results of operations.

We are also subject to payment card associations operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments, could have a material adverse effect on our business, prospects, financial condition and results of operations.

Events 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, could have a material adverse effect on our business, prospects, financial condition and results of operations.

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

We allow our customers to return products, subject to our returns policies. If merchandise returns are significant, our business, prospects, financial condition and results of operations could be harmed. Further, we modify our policies relating to returns from time to time and any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer repeat customers.

Our pricing strategy may not meet customers price expectations or result in net income.

Demand for our products is generally highly sensitive to price. Our pricing strategies have had, and may continue to have, a significant impact on our net sales and net income. We often offer discounted prices, and free or discounted shipping as a means of attracting customers and encouraging repeat purchases. Such offers and discounts reduce our margins. In addition, our competitors pricing and marketing strategies are beyond our control and can significantly impact the results of our pricing strategies. If we fail to meet our customers price expectations, or if we are unable to compete effectively with our competitors when they engage in aggressive pricing strategies or other competitive activities, our business, prospects, financial condition and results of operations would suffer.

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

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

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business, prospects, financial condition and results of operations.

We face risks relating to our inventory.

In our direct business, we sell merchandise that we have purchased and hold in inventory. We assume the risks of inventory damage, theft and obsolescence, as well as risks of price erosion for these products. These risks are especially significant because some of the merchandise we sell is characterized by seasonal trends, fashion trends, rapid technological change, obsolescence and price erosion (for example, computer hardware, software and consumer electronics) and because we sometimes make large purchases of particular types of inventory. In addition, we often do not receive warranties on the merchandise we purchase. Subject to our returns policies, we accept returns of products sold through our fulfillment partners and we have the risk of reselling the returned products.

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

We purchase some of our inventory from foreign suppliers and pay for inventory with U.S. dollars. If the dollar weakens with respect to foreign currencies, foreign suppliers may require us to pay higher prices for products, which could negatively affect our profit margins.

If we do not successfully optimize and operate our warehouse and customer service operations, our business could be harmed.

We have expanded, contracted and otherwise modified our warehouse and customer service operations in the past, and expect that we will continue to do so. If we do not successfully optimize and operate our warehouse and customer service operations, it could significantly limit our ability to meet customer demand or result in excessive costs and expenses for the size of our business. Because it is difficult to predict demand, we may not manage our facilities in an optimal way, which may result in excess or insufficient inventory or warehousing capacity. We may fail to staff our fulfillment and customer service centers at optimal levels. In addition, we rely on a limited number of companies to deliver inventory to us and to ship orders to our customers. If we are not able to negotiate acceptable terms with these companies, or they experience performance problems or other difficulties, it could negatively impact our operating results and customer experience.

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

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel. Our performance also depends on our ability to retain and motivate other officers and key employees. The loss of the services of any of our executive officers or other key employees for any reason, including without limitation, illness or call to military service, or loss to competitors as a result of compensation differentials or other reasons, could harm our business, prospects, financial condition and results of operations. We do not have employment agreements with any of our key personnel and we do not maintain key person life insurance policies.

Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense, and we cannot assure that we will be able to successfully attract, assimilate or retain sufficiently qualified personnel. Our failure to retain and attract the necessary technical, managerial, editorial, merchandising, marketing, and customer service personnel could harm our business, prospects, financial condition and results of operations.

We have an evolving business model.

Our business model has evolved and continues to do so. In the past we have added additional types of services and product offerings and, in some cases we have modified or discontinued those offerings. We may continue to try to offer additional types of products or services and we cannot offer any assurance that any of them will be successful. From time to time we have also modified aspects of our business model relating to our product mix and the mix of direct/fulfillment partner sourcing of the products we offer. We may continue to modify this aspect of our business as well as other significant aspects of our business. We cannot offer any assurance that these or any other modifications will be successful or will not result in harm to the business. The additions and modifications to our business have increased the complexity of our business and placed significant strain on our management, personnel, operations, systems, technical performance, financial resources, and internal financial control and reporting functions. Future additions to or modifications of our business are likely to have similar effects. We may not be able to manage growth effectively, which could damage our reputation, limit our growth and negatively affect our operating results.

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Our foreign brand domain name may cause confusion in foreign markets.

In July, 2010, we undertook an effort to associate our brand globally with the domain address: www.O.co. We did this in part because in many foreign markets the word Overstock lacked a good foreign cognate. Following a period of testing for the O.co brand and domain address, we returned to the Overstock.com name as our primary brand domestically because domestic consumer acceptance did not occur as quickly as we had hoped. While we have returned domestically to the Overstock.com brand and principal domain address, there is no assurance that the use of Overstock.com or O.co will gain acceptance or have success in foreign markets.

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

Our long-term strategic plan involves expansion of our operations to offer additional types of products and services. We may not be able to expand our business in this manner. Our failure to succeed in these markets or businesses or in other product or service offerings may harm our business, prospects, financial condition and results of operation. We cannot give any assurance that we will be able to expand our operations in a cost-effective or timely manner or that our efforts to expand will be successful. Furthermore, any new business or website we launch that is not favorably received by consumers could damage our reputation or the Overstock.com brand. We may expand the number of categories of products we carry on our Website and these and any other expansions of our operations would also require significant additional expenses and development and would strain our management, financial and operational resources. The lack of market acceptance of such efforts or our inability to generate satisfactory revenues from such expanded services or products to offset their cost could harm our business, prospects, financial condition and results of operations.

We are attempting to expand our international business, which may cause our business to become increasingly susceptible to numerous international business risks and challenges that could affect our profitability.

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

- the need to develop new supplier and manufacturer relationships;
- the need to comply with additional U.S. and foreign laws and regulations to the extent applicable, including but not limited to, restrictions on advertising practices, regulations governing online services, restrictions on importation of specified or proscribed items, importation quotas, consumer protection laws, enforcement of intellectual property rights, laws dealing with consumer and data protection, privacy, encryption, and restrictions on pricing or discounts;
- changes in international laws, regulatory requirements, taxes and tariffs; and
- geopolitical events, such as war and terrorist attacks.

To the extent we generate international sales and transactions in the future, any negative impact on our international operations could negatively impact our business. In particular, gains and losses on the conversion of foreign payments into U. S. dollars may contribute to fluctuations in our results of operations and fluctuating exchange rates could cause reduced gross revenues and/or gross profit percentages from non-dollar-denominated international sales. Additionally, penalties for non-compliance with laws applicable to international business and trade, such as the U.S. Foreign Corrupt Practices Act, could negatively impact our business.

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

Our success depends on our ability to attract and retain customers on cost-effective terms. We have relationships with online services, search engines, affiliate marketing websites, directories and other website and e-commerce businesses to provide content, advertising banners and other links that direct customers to our Website. We rely on these relationships as significant sources of traffic to our Website and to generate new customers. As discussed below, in the past we have terminated affiliate marketing websites as a result of efforts by certain states to require us to collect sales taxes. If we are unable to develop or maintain these relationships on acceptable terms, our ability to attract new customers and our financial condition could be harmed. If the underlying technology s development evolves in a manner that is no longer beneficial to us our financial condition could be harmed. In addition, certain of our online marketing agreements may require us to pay upfront fees and make other payments prior to the realization of the sales, if any, associated with those payments. Accordingly, if these relationships or agreements that we may enter into in the future fail to produce the sales that we anticipate, our results of operations will be adversely affected. We cannot give any assurance that we will be able to increase our revenues, if at all, in a cost-effective manner. We periodically conduct national television and radio branding and advertising campaigns. Such campaigns are expensive and may not result in the cost-effective acquisition of customers.

Further, many of the parties with which we may have online-advertising arrangements could provide advertising services for other online or traditional retailers and merchandise liquidators. As a result, these parties may be reluctant to enter into or maintain relationships with us. Failure to achieve sufficient traffic or generate sufficient revenue from purchases originating from third parties

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may result in termination of these relationships by these third parties. Further, in the past we have terminated our relationships with third party Internet advertising affiliates in certain states as a result of efforts by those states to require us to collect sales taxes based on the presence of those third party Internet advertising affiliates in those states, and we are likely do so again in the future if necessary. Without these relationships, our business, prospects, financial condition and results of operations could suffer.

We rely upon paid and natural search engines like Google, Bing, and Yahoo to rank our product offerings and may at times be subject to ranking penalties if they believe we are not in compliance with their guidelines.

We rely on paid and natural search engines to attract consumer interest in our product offerings. Potential and existing customers use search engines provided by search engine companies, including Google, Bing, and Yahoo, which use algorithms and other devices to provide users a natural ranked listing of relevant Internet sites matching a user s search criteria and specifications. Generally, Internet sites ranked higher in the paid and natural search results lists furnished to users attract the largest visitor share among similar Internet sites. Among retail internet sites, those sites achieving the highest natural search ranking often benefit from increased sales. Natural search engine algorithms utilize information available throughout the Internet, including information available on our site. Rules and guidelines of these natural search engine companies govern our participation on their sites and how we share relevant Internet information that may be considered or incorporated into the algorithms utilized by these sites. If these rules and guidelines, or the search engine algorithms shift suddenly or dramatically, or if we fail to present, or improperly present, our site information for use by natural search engine companies, or if any of these natural search engine companies determine that we have violated their rules or guidelines, as Google did in February 2011 through April 2011, or if others improperly present our site information to these search engine companies, we may fail to achieve an optimum ranking in natural search engine listing results, or we may be penalized in a way that could harm our business, prospects, financial condition and results of operations.

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

The online retail market is rapidly evolving and intensely competitive. Barriers to entry are minimal, and current and new competitors can launch new websites at a relatively low cost. We currently compete with numerous competitors, including:

- liquidation e-tailers such as SmartBargains;
- online retailers with discount departments such as Amazon.com, Inc., eBay, Inc. and Buy.com, Inc.;
- private sale sites such as Rue La La and Gilt Groupe;
- online specialty retailers such as Bluefly, Inc., Blue Nile, Inc. and Zappos.com; and traditional general merchandise and specialty retailers and liquidators such as Ross Stores, Inc., Wal-Mart Stores, Inc., Costco Wholesale Corporation, J.C. Penny Company, Inc., Sears Holding Corporation, Target Corporation, Best Buy Co., Inc., Home Depot, Inc. and Barnes and Noble, Inc., all of which also have an online presence.

We expect the online retail market to become even more competitive as traditional liquidators and online retailers continue to develop services that compete with our services. In addition, more traditional manufacturers and retailers may decide to create their own websites to sell their own excess inventory and the excess inventory of third parties. Conversely, online retailers may create proprietary, store-based distribution channels,

or in combination with traditional retailers arrange for their online products to be available to the customers of traditional retailers. Competitive pressures created by any one of our competitors, or by our competitors collectively, or in combination one with another, could harm our business, prospects, financial condition and results of operations.

Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service or marketing decisions or acquisitions that could harm our business, prospects, financial condition and results of operations. For example, to the extent that we enter new lines of businesses such as third-party logistics, or discount brick and mortar retail, we would be competing with large established businesses such as APL Logistics and Ross Stores, Inc. In the past we have entered the online auctions, car listing and real estate listing businesses, travel and insurance shopping businesses in which we compete or competed with large established businesses including eBay, Inc., AutoTrader.com, Inc. and Realtor.com. We no longer offer online auctions services or real estate listing services.

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

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

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

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

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

If the facility where substantially all of our computer and communications hardware is located fails, our business, prospects, financial condition and results of operations could be harmed.

If the facility where substantially all of our computer and communications hardware is located fails, or we suffer an interruption or degradation of services through the facility for any reason, our business, prospects, financial condition and results of operations could be harmed.

Our success, and in particular, our ability to successfully receive and fulfill orders and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications systems. Substantially all of our computer and communications hardware is located at a single co-location facility in Salt Lake City, Utah, with a partially redundant back-up system located less than six miles from the co-location facility. In the event of an earthquake or major local disaster, or any other man-made or natural cause of interruption of service, both our primary and back-up sites could be adversely affected. Although we have designed our back-up system in an effort to minimize service interruptions in the event of a failure of our main facility, our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, cyber-attacks, acts of war, break-ins, earthquake and similar events. In the event of a failure of our primary facility, the failover to our back-up facility would take at least several hours, during which time our Website would be completely shut down. Our back-up facility is designed to support sales at a level slightly above our average daily sales, but is not adequate to support sales at a high level. The back-up facility may not process effectively during time of higher traffic to our Website and may process transactions more slowly and may not support all of the functionality of our primary site. These limitations could have an adverse effect on our

conversion rate and sales. Our disaster recovery plan may be inadequate, and we do not carry business interruption insurance sufficient to compensate us for losses that could occur. Despite the implementation of network security measures, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, the occurrence of any of which could lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could harm our business, prospects, financial condition and results of operations.

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

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

Our failure to protect our software and other proprietary intellectual property rights or to develop technologies that are as good as our competitors could put us at a disadvantage to our competitors. In addition, the failure of the third parties whose products we offer

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for sale on our Website to protect their intellectual property rights, including their domain names, could impair our operations. These failures could harm our business, prospects, financial condition and results of operations.

We may be accused of infringing intellectual property rights of third parties.

Other parties have claimed and may claim that we infringe their intellectual property rights. We have been and are subject to, and expect to continue to be subject to, legal claims of alleged infringement of the intellectual property rights of third parties. The ready availability of damages, royalties and the potential for injunctive relief has increased the defense litigation costs of patent infringement claims, especially those asserted by third parties whose sole or primary business is to assert such claims. Such claims, even if not meritorious, may result in significant expenditure of financial and managerial resources, and the payment of damages or settlement amounts. Additionally, we may become subject to injunctions prohibiting us from using software or business processes we currently use or may need to use in the future, or requiring us to obtain licenses from third parties when such licenses may not be available on financially feasible terms or terms acceptable to us or at all. In addition, we may not be able to obtain on favorable terms, or at all, licenses or other rights with respect to intellectual property we do not own in providing e-commerce services to other businesses and individuals under commercial agreements.

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

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

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

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

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

We sell products internationally and consequently we are subject to risks of doing business internationally as related to our intellectual property, including:

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

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

Use of social media may adversely impact our reputation.

There has been a marked increase in use of social media platforms and similar devices, including weblogs (blogs), social media websites, and other forms of Internet-based communications which allow individual access to a broad audience of consumers and other interested persons. Consumers value readily available information concerning retailers, manufacturers, and their goods and services and often act on such information without further investigation, authentication and without regard to its accuracy. The availability of information on social media platforms and devices is virtually immediate as is its impact. Social media platforms and devices immediately publish the content their subscribers and participants post, often without filters or checks on accuracy of the content posted. The opportunity for dissemination of information, including inaccurate information, is virtually limitless. Information concerning or affecting us may be posted on such platforms and devices at any time. Information posted may be inaccurate and adverse to us, and it may harm our performance, prospects or business. The harm may be immediate without affording us an opportunity for redress or correction. Such platforms also could be used for the dissemination of trade secret information or compromise of other valuable company assets, any of which could harm our business, prospects, financial condition and results of operations.

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

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our Website infringe third-party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties past, current or future intellectual property rights.

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

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

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

We are involved in substantial litigation.

From time to time we receive claims of and become subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct 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 or equitable remedies. In addition, we have in the past been, are now, and in the future may be, involved in substantial litigation in which we are the plaintiff, including litigation regarding the constitutionality of certain state tax laws, and the prime broker litigation described below. Any of such litigation, whether as plaintiff or defendant, could be costly and time consuming and could divert management and key personnel from our regular business operations. We do not currently believe that any of our outstanding litigation will have a material adverse effect on our business, prospects, financial condition or results of operations. However, due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, prospects, financial condition and results of operations.

Our prime broker litigation may have an adverse effect on our business and financial condition.

We remain involved in substantial litigation against Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P., Merrill Lynch, Pierce, Fenner & Smith, Inc., and Merrill Lynch Professional Clearing Corporation, and the use of management s

time and attention in connection with the litigation and related matters may reduce the time management is able to spend on other aspects of our business, which may have adverse effects on other aspects of our business. We may be ordered to pay allowable court costs which could be substantial. To the extent that any such adverse effects exceed any benefits we may realize from the litigation, it could harm our business, prospects, financial condition and results of operation.

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

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

We rely on encryption and authentication technology licensed from third parties as well internally developed technology to provide the security and authentication necessary to effect secure transmission of confidential information such as customer credit card numbers. We cannot provide assurance that our technology can prevent breaches of the systems that we use to protect customer data. If any such compromise of our security were to occur, it could harm our business, prospects, financial condition and results of operations. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our

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operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. We cannot give any assurance that our security measures will prevent security breaches or that failure to prevent such security breaches will not harm our business, prospects, financial condition and results of operations.

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

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

We have indebtedness.

As of September 30, 2012, we had indebtedness of $18.5 million. Although we have reduced our indebtedness substantially over the last several years, the degree to which we are indebted could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations is dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

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

Public statements we or our chief executive officer, Patrick M. Byrne, have made or may make in the future may antagonize regulatory officials or others.

We and our chief executive officer, Patrick M. Byrne, have from time to time made public statements regarding our or his beliefs about matters of public interest, including statements regarding naked short selling. Some of those public statements have been critical of the Securities and Exchange Commission and other regulatory agencies. These public statements may have consequences for us, whether as a result of increased regulatory scrutiny or otherwise.

California District Attorneys have sued us for alleged violations of California law.

In April 2008, we received a letter from the Office of the District Attorney of Marin County, California, stating that the District Attorneys of Marin and four other counties in Northern California had begun an investigation into the way we advertise products for sale. In November 2010, District Attorneys for the California Counties of Alameda, Marin, Monterey, Napa, Santa Clara, Shasta and Sonoma filed a lawsuit seeking damages and an injunction, alleging 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 asks for damages in the amount of not less than $15 million. We dispute the allegations and intend to defend ourselves vigorously. However, an unfavorable resolution of this matter could materially affect our business, prospects, financial condition and results of operations.

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

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

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Current and future laws could affect our car listing business.

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

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

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

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

We are aware that other companies operating online car listing service have periodically received complaints from users alleging improprieties in connection with listings and occasionally these complaints may result in regulatory action. With any online listing service there is the possibility that sellers may attempt to employ bait and switch techniques, attracting consumers with advertisements of low cost, good condition vehicles in hopes of switching buyer interest to another less favorable vehicle once a potential purchaser responds. Additionally, sellers may attempt to sell vehicles without accurate descriptions of the condition of the vehicles. We have occasionally received complaints of this nature regarding our car listing service. In response to serious or repeat complaints concerning a car dealer, we may take action to prohibit such persons from listing inventory, but we do not have the ability to require users of our services to fulfill their obligations to make accurate disclosures or comply with consumer laws prohibiting bait and switch or other prohibited seller tactics. We are aware that other companies providing similar services periodically are threatened or by or subject to legal actions against the listing service for damages because of user conduct. We may encounter similar legal actions in connection with our cars listing service, which may harm our business or reputation among consumers.

Our insurance coverage and indemnity rights may not adequately protect us against loss.

Although we maintain liability and other types of insurance, including but not limited to, property, workers compensation, general liability, product liability, and security and privacy breach insurance, we cannot be certain that the types, coverage, or the amounts of coverage we maintain will be adequate for losses actually incurred, or that the insurance will continue to be available to us on economically reasonable terms. Similarly, although we are indemnified by most of our suppliers and vendors for product liability for products they supply us, and we have indemnification agreements with software and hardware suppliers for losses we might incur as a result of the use of the technology products they

supply, we are not indemnified by all our suppliers, nor can we be certain that our indemnification rights are enforceable or adequate to cover actual losses we may incur as a result of the sale or use of products our indemnitors provide to us. Actual losses for which we are not insured or indemnified, or which exceed our insurance coverage or the capacity of our indemnitors, could harm our business, prospects, financial condition and results of operations.

Our travel site service is a relatively new business that may not succeed.

Our travel site began operation in April 2011. The listing site hosted by Priceline Partner Network Limited (Priceline.com) is for travel and travel related products and services. While we have offered vacation package services and products previously, the online travel business is a relatively new business for us. We cannot ensure that our expansion into the business will succeed. Our entry into the business will require us to devote financial, technical, managerial and other resources to this travel site. It also exposes us to additional risks, including legal and regulatory risks, and it requires us to compete with established businesses having substantially greater experience in the travel service business and substantially greater resources than we have.

Current and future laws could affect our travel site business.

Like our shopping business, our travel site business is subject to most of the same laws and regulations that apply to other companies conducting business on and off the Internet. In addition, our travel site business may be affected by other laws and regulations, such as those that expressly apply to sales of travel-related products or services. Our failure or the failure of Priceline.com to follow current or future laws or regulations could harm our business.

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Natural disasters and geo-political events could adversely affect our financial performance.

The occurrence of one or more natural disasters, such as hurricanes, cyclones, typhoons, tropical storms, floods, earthquakes, tsunamis, weather conditions such as major or extended winter storms, droughts and tornados, whether as a result of climate change or otherwise, or geo-political events, such as civil unrest or terrorist attacks in a country in which our suppliers are located, could adversely affect our suppliers in the areas in which these types of events occur. The occurrence of any of these events could materially affect our business, prospects, financial condition and results of operations.

Our insurance business is a relatively new business that may not succeed in the long-term.

Our insurance business site began operation in July 2011. The insurance site allows customer to comparison shop for home and auto insurance. The online insurance business site is a relatively new business for us. We cannot ensure that our expansion into this business will succeed. Our entry into the business will require us to devote financial, technical, managerial and other resources to this insurance business site. It will also expose us to additional risks, including legal and regulatory risks, and it will require us to compete with established businesses having substantially greater experience in the online insurance business, including insurance business comparison shopping sites which have substantially greater resources than we have.

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

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

Current and future laws could affect our insurance business.

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

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

The law regarding the potential liability of an online service providing a platform for sales of insurance products is not clear. The platform of the insurance business site is accessible to insurance product vendors who have insurance products for sale, and which describe these products to customer and inform them of other important information related to the insurance products and the companies which sell them. We have no ability to know whether the information insurance sellers provide is correct. While our site terms and conditions of usage prohibit unlawful acts, we cannot rule out the possibility that insurance sellers will engage in unlawful transactions, or fail to comply with all laws and regulations applicable to them and their transactions. We may be subject to allegations of civil or criminal liability for any unlawful activities conducted by such users. Any costs we incur as a result of any such allegations, as a result of actual or alleged unlawful transactions using our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the O.co and Overstock.com brand names generally.

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

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

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

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

Our long-term future depends heavily upon the general public s willingness to use the Internet as a means to purchase goods. Though e-commerce is widely accepted as a means of purchasing consumer goods and services, we cannot give any assurance that it will continue to be widely accepted. The demand for and acceptance of products sold over the Internet are still uncertain and most e-commerce businesses have a short track record. If consumers are unwilling to use the Internet to conduct business, it would materially adversely impact our business, prospects, financial condition and results of operations.

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

In order for the e-commerce market to continue to develop successfully, we and other market participants must be able to protect and transmit confidential information securely over public networks. Third parties have demonstrated that they can breach the security of customer transaction data of large sophisticated internet retailers, government organizations and others. Any breach of our e-commerce security systems could cause customers to lose confidence in the security of our Website and choose not to purchase from our Website. Similarly, if there are additional breaches of e-commerce security systems operated by other large e-commerce retailers, whether or not the breaches affect us or the systems we operate such breaches could cause could also cause our customers to lose confidence in the security of our site. If someone is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt our operations. Concerns about the security and privacy of transactions over the Internet could inhibit the use of the Internet and e-commerce. Our security measures may not effectively prohibit others from obtaining improper access to our information. Third parties may target our customers directly with fraudulent identity theft schemes designed to appear as legitimate communications from us. Any security breach or fraud perpetrated on our customers could expose us to increased costs and to risks of loss, litigation and liability and could seriously disrupt our operations. Similar activities targeting other large e-commerce sites, if successful, could similarly cause serious disruption to our operations and business.

We are subject to cyber security risks and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents.

Our business is entirely dependent on the secure operation of our website and systems as well as the operation of the internet generally. Our business involves the storage and transmission of users proprietary information, and security breaches could expose us to a risk of loss or misuse of this information, litigation, and potential liability. A number of large internet companies have disclosed security breaches, some of which have involved intentional attacks. From time to time we and many other Internet businesses also experience denial of service attacks wherein attackers attempt to block customer s access to our Website. If we are unable to avert a denial of service attack for any significant period, we could sustain substantial revenue loss from lost sales and customer dissatisfaction. We may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. Cyber attacks may target us, our customers, our suppliers, e-commerce in general or communication infrastructure on which we depend. If an actual or perceived attack or breach of our security occurs, customer and/or supplier perception of the effectiveness of our security measures could be harmed and we could lose customers, suppliers or both. Actual or anticipated attacks and risks may cause us to incur increasing costs, including costs to deploy additional personnel and protection technologies, train employees, and engage third party experts and consultants.

A person who is able to circumvent our security measures could misappropriate our or our users proprietary information, cause interruption in our operations, damage our computers or those of our users, or otherwise damage our reputation and business. Any compromise of our security could result in a violation of applicable privacy and other laws, significant legal and financial exposure, damage to our reputation, and a loss of confidence in our security measures, which could harm our business.

Most of our customers use credit cards to pay for their purchases. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication to effectively secure transmission of confidential information, including customer payment card numbers. We cannot provide assurance that our technology can prevent breaches of the systems that we use to protect customer data. Data breaches can also occur as a result of non-technical issues.

Under payment card rules and our contracts with our card processors, if there is a breach of payment card information that we store, we could be liable to the payment card issuing banks for their cost of issuing new cards and related expenses. In addition, if we fail to follow payment card industry security standards, even if there is no compromise of customer information, we could incur significant fines or lose our ability to give customers the option of using payment cards to fund their payments or pay their fees. If we were unable to accept payment cards, our business would be seriously damaged.

Our servers and the servers of our suppliers are also vulnerable to computer viruses, physical or electronic break-ins, and similar disruptions, including denial-of-service attacks. We may need to expend significant resources to protect against attacks or security breaches or to address problems caused by attacks or breaches. Any attack or breach incident involving us or persons with whom we have commercial relationships, that results in the unauthorized release of our users personal information, could damage our

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reputation and expose us to a risk of loss or litigation and possible liability.

Credit card fraud could adversely affect our business.

We routinely receive orders placed with fraudulent credit card data. We do not carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce our net revenues and our gross profit percentage. We have implemented technology to help us detect and reject the fraudulent use of credit card information. However, we may in the future suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we do not obtain a cardholder s signature. If we are unable to detect or control credit card fraud, our liability for these transactions could harm our business, prospects, financial condition and results of operation. Further, to the extent that our efforts to prevent fraudulent orders result in our inadvertent refusal to fill legitimate orders, we would lose the benefit of legitimate potential sales and risk the alienation of legitimate customers.

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

We do not currently collect sales or other similar taxes for physical shipments of goods into states where we have no duty to do so under federal court decisions construing applicable constitutional law. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us because we are engaged in online commerce, even though to do so would be contrary to existing court decisions. The future location of our fulfillment or customer service centers networks, or any other operation of the company, service contracts with third parties located in another state, channel distribution arrangements or other agreements with third party sellers, or any act that may be deemed by a state to have established a physical presence in states where we are not now present, may result in additional sales and other tax obligations. New York and other states have passed so-called Internet affiliate advertising statutes, which would require a remote seller, with no physical presence in the state, to collect state sales tax if the remote seller contracted for advertising services with an Internet advertiser in that state. In New York and states passing similar laws, we have terminated our use of locally based Internet advertisers. Moreover, there are other states that currently have similar tax proposals under consideration. In a case that is now on appeal, an Illinois state court struck down on constitutional grounds a similar Illinois statute. If such laws survive constitutional challenge, we may have to elect to discontinue in those states valuable marketing through the use of affiliates based in those states, or begin in those states the collection of the taxes. In either event, our business could be harmed and our business could be adversely affected if one or more states or any foreign country successfully asserts that we should collect sales or other taxes on the sale of our merchandise in compliance with these or any other state law. At least one state, Ohio, asserts that we should pay a commercial activity tax because we sell merchandise in Ohio, even though we have no physical presence there and has in June 2009 assessed us $612,784 in taxes, interest, and penalties as of June 30, 2009. The Ohio Department of Taxation issued additional estimated assessments of estimated tax, interest and penalties totaling $121,958 as of December 31, 2011, all of which we are contesting in administrative proceedings in Ohio. If Ohio is successful and its assessment withstands constitutional challenge in both administratively and in court appeals, the enforcement of the assessment could harm our business. If other states similarly enact and are successful in enforcing similar commercial activity tax laws, these also could harm our business.

Several other states have enacted laws requiring remote vendors to notify resident purchasers in those states of their obligation to pay a use tax on their purchases and, in some instances, to report untaxed purchases to the state tax authority. In Colorado, a federal court on constitutional grounds granted a preliminary injunction against the state s enforcement its tax-notice and reporting law. Notwithstanding, other states may enact legislation similar to these laws. Such laws could harm our business by imposing unreasonable notice burdens upon us, by interposing burdensome transaction notices that negatively affect conversion, or discourage customer purchases by requiring detailed purchase reporting which would threaten customers with an invasion of their privacy.

Economic pressure on states could harm our business.

The current economic climate has resulted in a sharp decline in state revenues, and states have projected large state budget shortfalls in the years ahead. These shortfalls require state legislatures and agencies to examine the means to increase state revenues. States may increase sales and use tax rates, create new tax laws covering previously untaxed activities, or increase existing licenses or create new fees all of which may directly or indirectly harm our business. Similarly, administrative agencies and executive agencies may apply more rigorous enforcement efforts, take inflexible, unreasonable or unprecedented positions respecting these laws they administer, especially if the laws they administer carry monetary penalties and fines which either the state or the administrative agency may use to balance their budgets. To the extent that states pass additional revenue measures, or significantly increase their enforcement efforts of existing laws, these activities could directly or indirectly harm our business.

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

We are subject to increasing regulation at the federal, state and international levels relating to privacy, security, retention,

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transfer and use of personal user information. For example, we are subject to various telemarketing laws that regulate the manner in which we may solicit future suppliers and customers. Such statutes and regulations, along with increased governmental or private enforcement, may increase the cost of our business. In addition, many jurisdictions have laws that limit the uses of personal user information gathered online or offline or require companies to establish privacy policies. For example, Federal Trade Commission regulations restrict the collection and use of personal identifying information obtained from children under 13. Laws affecting privacy, security, retention, transfer and use of personal user information have been passed by several jurisdictions, both domestic and foreign, including laws that require us to establish procedures to notify users of privacy and security policies, obtain consent from users for collection and use of personal information, and/or provide users with the ability to access, correct and delete personal information stored by us. Compliance with new and existing privacy and security laws is difficult and costly, as interpretation and application of these laws evolves over time. Additional restrictions and requirements regarding data security and privacy are under nearly continuous consideration by foreign countries, Congress and various states. These data protection statutes, regulations and interpretations may further restrict our ability to collect demographic and personal information from users, which could be costly or harm our marketing efforts, and could require us to implement new and potentially costly processes, procedures and/or protective measures.

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

The market price of our common stock historically has been subject to significant fluctuations. These fluctuations could continue. It is possible that in future periods our results of operations may be below the expectations of public market analysts and investors. If this occurs, the market price of our securities may decline. Some of the factors that could affect the market price of our securities are as follows:

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

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

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

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

- increases in the cost of advertising;
- our inability to retain existing customers or encourage repeat purchases;
- the extent to which our existing and future marketing campaigns are successful;
- price competition that results in lower profit margins or losses;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;
- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- increases in the cost of fuel and transportation;
- our ability to successfully integrate operations and technologies from acquisitions or other business combinations;
- our efforts to offer new lines of products and services; and

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- our ability to attract users to our shopping and other sites.

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

We have experienced and expect to continue to experience fluctuations in our operating results because of seasonal fluctuations in traditional retail patterns. Sales in the retail and wholesale industry tend to be significantly higher in the fourth calendar quarter of each year than in the preceding three quarters due primarily to increased shopping activity during the holiday season. However, there can be no assurance that our sales in the fourth quarter will exceed those of the preceding quarters or, if the fourth quarter sales do exceed those of the preceding quarters, that we will be able to manage the increased sales effectively. Further, we generally increase our inventories substantially in anticipation of holiday season shopping activity, which has a negative effect on our cash flow. Securities analysts and investors may inaccurately estimate the effects of seasonality on our results of operations in one or more future quarters and, consequently, our operating results may fall below expectations, causing the market price of our securities to decline. We generally have payment terms with our fulfillment partners that extend beyond the amount of time necessary to collect proceeds from our customers. As a result of holiday sales, at December 31 of each year, our cash, cash equivalents, and marketable securities balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). This operating cycle results in a corresponding increase in accounts payable at December 31. Our accounts payable balance generally declines during the first three months of the year, resulting in a corresponding decline in our cash, cash equivalents, and marketable securities balances.

Sales by our significant stockholders could have an adverse effect on the market price of our stock.

Several of our stockholders own significant portions of our common stock. If one or more of stockholders were to sell all or a portion of their holdings of our common stock, the market price of our common stock could be negatively impacted. The effect of such sales, or of significant portions of our stock being offered or made available for sale, could result in strong downward pressure on our stock price. Investors should be aware that they could experience significant short-term volatility in our stock if such stockholders decide to sell all or a portion of their holdings of our common stock at once or within a short period of time. In addition, the transfer of ownership of 50% or more of our outstanding shares within a three year period could adversely affect our ability to use our net operating losses to offset future taxable net income.

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

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

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

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

The price of our stock may be vulnerable to manipulation.

We filed an unfair business practice lawsuit against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc., and settled the case with respect to all

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defendants except Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P.; Merrill Lynch, Pierce, Fenner & Smith, Inc., and Merrill Lynch Professional Clearing Corporation. In January, the trial court granted the remaining defendants motion for summary judgment. We intend to appeal the ruling.

We believe these remaining defendants engaged in unlawful actions and have caused substantial harm to Overstock, and that certain of the defendants have made efforts to drive the market price of Overstock s common stock down. To the extent that the defendants or other persons engage in any such actions or take any other actions to interfere with or destroy or harm Overstock s existing and/or prospective business relationships with its suppliers, bankers, customers, lenders, investors, prospective investors or others, our business, prospects, financial condition and results of operation could be harmed, and the price of our common stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of any such efforts. The practice of abusive naked short selling continues to place our stock at risk for manipulative attacks by large investment pools and prime brokers.

Abusive naked short selling is the practice by which short sellers place large short sell orders for shares without first borrowing the shares to be sold, or without having first adequately located such shares and arranged for a firm contract to borrow such shares prior to the delivery date set to close the sale. While selling broker dealers are by rule required to deliver shares to close a transaction by a certain date, and while purchasing broker-dealers are obligated by rule to purchase the sold quantity of shares when they are not delivered to close the sale, these rules are often ignored. Abusive naked short selling has a depressive effect on share prices when it is allowed to persist because the economic effect of abusive naked short selling is the oversupply of counterfeit stock to the market. We believe the regulations designed to address this abusive practice are both inadequately structured and inadequately enforced. Consequently, we believe that without the enactment of adequate regulations and the enforcement necessary to curb these abuses, the manipulations achieved through abusive naked short selling are likely to continue. We believe that our stock has been subject to these abusive practices by those attempting to manipulate its price downward. To the extent that our stock is subject to these practices in the future, our stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of such abuses.

In the past, our stock has consistently been on the Regulation SHO threshold list.

Regulation SHO requires the stock exchanges to publish daily a list of companies whose stock has failures-to-deliver above a certain threshold. It also requires mandatory close-outs for open fail-to-deliver positions in threshold securities persisting for over 13 days, with the aim that no security would appear on the threshold for any extended period. Despite that aim, our common stock has frequently appeared on the Regulation SHO threshold list for extended and continuous periods and, while we do not currently appear on the Regulation SHO threshold list, in the past our stock has been on the list for more trading days than any other company.

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

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

(a) Exhibits

31.1	Exhibit 31.1 Certification of Chief Executive Officer
31.2	Exhibit 31.2 Certification of Chief Financial Officer
32.1	Exhibit 32.1 Section 1350 Certification of Chief Executive Officer
32.2	Exhibit 32.2 Section 1350 Certification of Chief Financial Officer
101	The following financial information from our Quarterly Report on From 10-Q for the third quarter of fiscal 2012, filed with the SEC on October 25, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income (Loss), (iii) Consolidated Statements of Cash Flows, (iv) Consolidated Statements of Stockholders Equity, and (v) Notes to Consolidated Financial Statements.(1)

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(1) Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Act of 1934 and otherwise are not subject to liability under these sections.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 25, 2012

OVERSTOCK.COM, INC.

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