OVERSTOCK.COM, INC
Form 10-Q/A
March 15, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Mark One)

ý	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended June 30, 2005
	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)

Former address:
6322 South 3000 East, Suite 100
Salt Lake City, Utah 84121

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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes ý No o

There were 18,694,981 shares of the Registrant s common stock, par value $0.0001, outstanding on August 2, 2005.

EXPLANATORY NOTE

On February 27, 2006, Overstock.com, Inc. (Company) filed its Current Report on Form 8-K with the Securities and Exchange Commission (SEC) in which it announced that it was restating previously reported financial statements to correct an error related to the accounting for freight costs incurred to deliver inventory to its warehouses. As more fully described in Note 2 of the financial statements, the Company has determined that the misstatements relate to the Company s historical practice of immediately expensing inbound freight costs in the period incurred rather than capitalizing such costs as a component of inventory and expensing such costs as the related inventory is sold. This Amendment No. 1 to Form 10-Q/A (Amendment) amends the Quarterly Report on Form 10-Q for the quarter end June 30, 2005 (Original Filing), as filed on August 9, 2005.

Except as required to reflect the effects of the restatement for the item above, no additional modifications or updates in this Amendment have been made to the Original Filing on Form 10-Q. Information not affected by the restatement remains unchanged and reflects the disclosures made at the time of the Original Filing. This amendment does not describe other events occurring after the original filing, including exhibits, or modify or update those disclosure affected by subsequent events. This Amendment should be read in conjunction with the Company s filings made with the SEC subsequent to the filing of the Original Filing, as information in such reports and documents may update or supersede certain information contained in this Amendment. Accordingly, this Amendment only amends and restates Items 1, 2 and 4 of Part I of the Original Filing, in each case, solely as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby. Additionally, pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to contain currently dated certifications of the President and Senior Vice President, Finance. As required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, the certifications of our President and Senior Vice President, Finance, are attached to this Amendment as Exhibits 31.1, 31.2 and 32.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited) (Restated)
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Item 3. Quantitative and Qualitative Disclosures about Market Risk
Item 4. Controls and Procedures
PART II. OTHER INFORMATION
Item 1. Legal Proceedings
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
Item 3. Defaults upon Senior Securities
Item 4. Submission of Matters to a Vote of Security Holders
Item 5. Other Information
Item 6. Exhibits
Signature

PART 1. FINANCIAL INFORMATION

ITEM 1 . FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets

(in thousands)

(Unaudited)

	December 31, 2004 (Restated)	June 30, 2005 (Restated)
Assets		
Current assets:		
Cash and cash equivalents	$ 198,678	$ 31,350
Marketable securities	88,802	88,625
Cash, cash equivalents and marketable securities	287,480	119,975
Accounts receivable, net	5,715	13,649
Inventories, net	46,558	61,547
Prepaid inventory	12,322	10,410
Prepaid expenses and other assets	3,444	8,080
Total current assets	355,519	213,661
Restricted cash	1,602	833
Property and equipment, net	16,122	51,084
Goodwill	2,784	2,784
Other long-term assets, net	1,516	1,372
Total assets	$ 377,543	$ 269,734
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 64,060	$ 39,486
Accrued liabilities	22,917	25,411
Capital lease obligations, current	595	6,445
Total current liabilities	87,572	71,342
Capital lease obligations, non-current	743	7,038
Convertible senior notes	116,251	84,468
Total liabilities	204,566	162,848
Commitments and contingencies (Note 13)		
Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of December 31, 2004 and June 30, 2005	3,166	3,259

Stockholders equity:				
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2004 and June 30, 2005 respectively				
Common stock, $0.0001 par value, 100,000 shares authorized, 19,390 and 19,919 shares issued and 19,355 and 18,228 shares outstanding as of December 31, 2004 and June 30, 2005 respectively		2		2
Additional paid-in capital		243,131		247,751
Accumulated deficit		(71,726)		(78,052)
Unearned stock-based compensation		(1,301)		(510)
Treasury stock, 35 and 1,691 shares at cost as of December 31, 2004 and June 30, 2005, respectively		(100)		(65,337)
Accumulated other comprehensive loss		(195)		(227)
Total stockholders equity		169,811		103,627
Total liabilities, redeemable securities and stockholders equity	$	377,543	$	269,734

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

Overstock.com, Inc.

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three months ended June 30, 2004 (Restated)	Three months ended June 30, 2005 (Restated)	Six months ended June 30, 2004 (Restated)	Six months ended June 30, 2005 (Restated)
Revenue				
Direct	$ 41,113	$ 60,064	$ 79,693	$ 127,948
Fulfillment partner	46,679	90,574	90,177	188,571
Total revenue	87,792	150,638	169,870	316,519
Cost of goods sold				
Direct	36,645	51,562	71,504	109,822
Fulfillment partner	41,114	76,375	79,907	159,232
Total cost of goods sold	77,759	127,937	151,411	269,054
Gross profit	10,033	22,701	18,459	47,465
Operating expenses:				
Sales and marketing	6,605	14,495	10,982	31,320
Technology	1,830	6,094	3,201	10,189
General and administrative	3,737	7,531	8,617	14,864
Amortization of stock-based compensation	123	53	258	73
Total operating expenses	12,295	28,173	23,058	56,446
Operating loss	(2,262)	(5,472)	(4,599)	(8,981)
Interest income	127	896	225	1,540
Interest expense	(46)	(1,517)	(62)	(2,962)
Other income, net		4,170	2	4,170
Net loss	(2,181)	(1,923)	(4,434)	(6,233)
Deemed dividend related to redeemable common stock	(46)	(47)	(94)	(93)
Net loss attributable to common shares	$ (2,227)	$ (1,970)	$ (4,528)	$ (6,326)
Net loss per common share basic and diluted	$ (0.13)	$ (0.10)	$ (0.26)	$ (0.32)
Weighted average common shares outstanding basic and diluted	17,577	19,709	17,128	19,785

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

Overstock.com, Inc.

Consolidated Statements of Stockholders Equity

and Comprehensive Income (unaudited)

(amounts in thousands)

	Common stock Shares	Common stock Amount	Additional Paid-in Capital	Accumulated deficit	Unearned stock-based compensation	Treasury stock Shares	Treasury stock Amount	Accumulated Other Comprehensive Income (loss)	Total
Balance at December 31, 2004 (Restated)	19,390	$ 2	$ 243,131	$ (71,726)	$ (1,301)	(35)	$ (100)	$ (195)	$ 169,811
Exercise of stock options and warrants	529		3,908						3,908
Issuance of common stock from treasury			294			6	17		311
Purchase of treasury stock						(665)	(24,133)		(24,133)
Purchased call options			(47,507)						(47,507)
Settlement of purchased call options in exchange for cash			7,937						7,937
Settlement of purchased call options in exchange for treasury stock			41,121			(997)	(41,121)		
Forfeitures of unearned stock-based compensation from options issued to employees			(46)		46				
Amortization of stock-based compensation					73				73
Stock-based compensation to consultants in exchange for services			(1,087)		672				(415)
Deemed dividend related to redeemable common stock				(93)					(93)
Comprehensive income (loss):									

Net loss (Restated)				(6,233)					(6,233)
Unrealized loss on marketable securities								(6)	(6)
Cumulative translation adjustment								(26)	(26)
Total comprehensive loss									(6,265)
Balance at June 30, 2005 (Restated)	19,919	$ 2	$ 247,751	$ (78,052)	$ (510)	(1,691)	$ (65,337)	$ (227)	$ 103,627

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

5

Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended June 30,		Six months ended June 30,		Twelve months ended June 30,	
	2004 (Restated)	**2005 (Restated)**	**2004 (Restated)**	**2005 (Restated)**	**2004 (Restated)**	**2005 (Restated)**
Cash flows from operating activities:						
Net loss (Restated)	$ (2,181)	$ (1,923)	$ (4,434)	$ (6,233)	$ (10,977)	$ (6,339)
Adjustments to reconcile net loss to cash provided by (used in) operating activities						
Depreciation and amortization	890	2,930	1,646	4,565	2,953	6,856
Amortization of unearned stock-based compensation	123	53	258	73	612	175
Realized gain (loss) from marketable securities		(25)		(26)	(4)	(28)
Loss on disposition of property and equipment						34
Stock options issued to consultants for services	289	(15)	569	(415)	595	294
Amortization of debt discount and deferred financing fees		116		423		570
Gain from retirement of convertible senior notes		(4,170)		(4,170)		(4,170)
Issuance of common stock from treasury		60		311		311
Changes in operating assets and liabilities:						
Accounts receivable, net	4,620	755	3,604	3	1,641	868
Inventories, net	1,567	(11,419)	(1,020)	(14,989)	(11,738)	(29,784)
Prepaid inventory	(1,444)	(503)	(1,180)	1,912	(1,476)	1,912
Prepaid expenses and other assets	(896)	1,666	(1,250)	(4,636)	1,963	(13,330)
Other long-term assets, net	16	603	(1,370)	(11)	(1,251)	3
Accounts payable	6,937	(374)	(8,841)	(24,574)	14,020	17,965
Accrued liabilities	443	2,148	595	2,494	5,795	15,498
Net cash provided by (used in) operating activities	10,364	(10,098)	(11,423)	(45,273)	2,133	(9,165)
Cash flows from investing activities:						
Increase (decrease) in restricted cash	(1,875)	179	(1,875)	769	(1,875)	1,042
Investments in marketable securities	(9,684)	(36,047)	(12,242)	(161,991)	(26,589)	(242,626)
Sales of marketable securities	1,283	102,926	2,474	162,188	23,737	175,087
Expenditures for property and equipment	(1,199)	(11,246)	(1,599)	(24,276)	(6,606)	(31,411)
Proceeds from the sale of property and equipment						20
Expenditures for other long-term assets					(172)	
Net cash provided by (used in) investing activities	(11,475)	55,812	(13,242)	(23,310)	(11,505)	(97,888)
Cash flows from financing activities:						
Payments on capital lease obligations	(334)	(2,901)	(354)	(3,052)	(458)	(3,357)
Borrowings on line of credit	1,000		1,000		1,000	(1,000)
Issuance of common stock, net of issuance costs	37,857		37,857		37,857	75,207
Issuance of convertible senior notes						116,251
Payments to retire convertible senior notes		(27,935)		(27,935)		(27,935)
Purchased call options				(47,507)		(47,507)
Purchase of treasury stock		(24,133)		(24,133)		(24,133)
Exercise of stock options and warrants	792	3,002	2,959	3,908	3,401	5,238
Net provided by (used in) financing activities	39,315	(51,967)	41,462	(98,719)	41,800	92,764

Effect of exchange rate changes on cash	6	(8)	5	(26)	4	(9)
Net increase (decrease) in cash and cash equivalents	38,210	(6,261)	16,802	(167,328)	32,432	(14,298)
Cash and cash equivalents, beginning of period	7,438	37,611	28,846	198,678	13,216	45,648
Cash and cash equivalents, end of period	$ 45,648	$ 31,350	$ 45,648	$ 31,350	$ 45,648	$ 31,350

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

Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

(amounts in thousands, except per share data)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Overstock.com, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited annual consolidated financial statements and related notes thereto included in the Annual Report on Form 10-K/A for the year ended December 31, 2004. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and six months ended June 30, 2005 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

As more fully described in Note 2, the Company determined that the financial statements and the disclosures in the notes thereto for the three-month periods ended June 30, 2005 and 2004 contained in the Quarterly Report on Form 10-Q filed on August 9, 2005, require restatement. All amounts disclosed in the footnotes to the financial statements have been appropriately restated.

2. RESTATEMENT OF FINANCIAL STATEMENTS

On February 27, 2006, Overstock.com, Inc. (Company) filed its Current Report on Form 8-K with the Securities and Exchange Commission (SEC) in which it announced that it was restating previously reported financial statements to correct an error related to the accounting for freight costs incurred to deliver inventory to its warehouses. The Company has determined that the misstatements relate to the Company s former practice of immediately expensing inbound freight costs in the period incurred rather than capitalizing such costs as a component of inventory and expensing such costs as the related inventory is sold.

With respect to capitalization of inbound freight costs, AICPA Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 4, Inventory Pricing sets forth the general principles applicable to the pricing of inventories.

In late 2005, the Company reevaluated its prior accounting policy related to inbound freight charges. As a result, the Company concluded that inbound freight should have been capitalized as a component of inventory cost and expensed as a cost of goods sold as the inventory is sold.

Based upon this determination, the consolidated balance sheets as of December 31, 2004 and June 30, 2005 and the consolidated statements of operations for the quarters ended June 30, 2005 and 2004 contained herein have been restated. As the restatement adjustments decrease the net loss by $592 and $141 for the quarters ended June 30, 2005 and 2004, respectively, and increase inventory by the corresponding amount, there has been no impact on net cash provided by (used in) operating activities the consolidated statements of cash flows. The restated consolidated statements of operations and balance sheets have been restated as follows:

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three Months Ended June 30, 2005		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 60,064		$ 60,064
Fulfillment partner	90,574		90,574
Total revenue	150,638		150,638
Cost of goods sold			
Direct	52,154	(592)	51,562
Fulfillment partner	76,375		76,375
Total cost of goods sold	128,529	(592)	127,937
Gross profit	22,109	592	22,701
Operating expenses:			
Sales and marketing	14,495		14,495
Technology	6,094		6,094
General and administrative	7,531		7,531
Amortization of stock-based compensation	53		53
Total operating expenses	28,173		28,173
Operating loss	(6,064)	592	(5,472)
Interest income	896		896
Interest expense	(1,517)		(1,517)
Other income, net	4,170		4,170
Net loss	(2,515)	592	(1,923)
Deemed dividend related to redeemable common shares	(47)		(47)
Net loss attributable to common shares	$ (2,562)	$ 592	$ (1,970)
Net loss per common share basic and diluted	$ (0.13)	$ 0.03	$ (0.10)
Weighted average common shares outstanding basic and diluted	19,709		19,709

	Three Months Ended June 30, 2004		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 41,113		$ 41,113
Fulfillment partner	46,679		46,679
Total revenue	87,792		87,792
Cost of goods sold			
Direct	36,786	(141)	36,645
Fulfillment partner	41,114		41,114
Total cost of goods sold	77,900	(141)	77,759
Gross profit	9,892	141	10,033
Operating expenses:			
Sales and marketing	6,605		6,605
Technology	1,830		1,830
General and administrative	3,737		3,737
Amortization of stock-based compensation	123		123
Total operating expenses	12,295		12,295
Operating loss	(2,403)	141	(2,262)
Interest income	127		127
Interest expense	(46)		(46)
Other income, net			
Net loss	(2,322)	141	(2,181)
Deemed dividend related to redeemable common shares	(46)		(46)
Net loss attributable to common shares	$ (2,368)	$ 141	$ (2,227)
Net loss per common share basic and diluted	$ (0.13)	$ 0.00	$ (0.13)
Weighted average common shares outstanding basic and diluted	17,577		17,577

	Six Months Ended June 30, 2005		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 127,948		$ 127,948
Fulfillment partner	188,571		188,571
Total revenue	316,519		316,519
Cost of goods sold			
Direct	110,307	(485)	109,822
Fulfillment partner	159,232		159,232
Total cost of goods sold	269,539	(485)	269,054
Gross profit	46,980	485	47,465
Operating expenses:			
Sales and marketing	31,320		31,320
Technology	10,189		10,189
General and administrative	14,864		14,864
Amortization of stock-based compensation	73		73
Total operating expenses	56,446		56,446
Operating loss	(9,466)	485	(8,981)
Interest income	1,540		1,540
Interest expense	(2,962)		(2,962)
Other income, net	4,170		4,170
Net loss	(6,718)	485	(6,233)
Deemed dividend related to redeemable common shares	(93)		(93)
Net loss attributable to common shares	$ (6,811)	$ 485	$ (6,326)
Net loss per common share basic and diluted	$ (0.34)	$ 0.02	$ (0.32)
Weighted average common shares outstanding basic and diluted	19,785		19,785

	Six Months Ended June 30, 2004		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 79,693		$ 79,693
Fulfillment partner	90,177		90,177
Total revenue	169,870		169,870
Cost of goods sold			
Direct	71,602	(98)	71,504
Fulfillment partner	79,907		79,907
Total cost of goods sold	151,509	(98)	151,411
Gross profit	18,361	98	18,459
Operating expenses:			
Sales and marketing	10,982		10,982
Technology	3,201		3,201
General and administrative	8,617		8,617
Amortization of stock-based compensation	258		258
Total operating expenses	23,058		23,058
Operating loss	(4,697)	98	(4,599)
Interest income	225		225
Interest expense	(62)		(62)
Other income, net	2		2
Net loss	(4,532)	98	(4,434)
Deemed dividend related to redeemable common shares	(94)		(94)
Net loss attributable to common shares	$ (4,626)	$ 98	$ (4,528)
Net loss per common share basic and diluted	$ (0.27)	$ (0.00)	$ (0.27)
Weighted average common shares outstanding basic and diluted	17,128		17,128

Consolidated Balance Sheets

(in thousands)

(Unaudited)

	As of June 30, 2005 As Previously Reported	As of June 30, 2005 As Restated
Assets		
Current assets:		
Cash and cash equivalents	$ 31,350	$ 31,350
Marketable securities	88,625	88,625
Cash, cash equivalents and marketable securities	119,975	119,975
Accounts receivable, net	13,649	13,649
Inventories, net	59,783	61,547
Prepaid inventory	10,410	10,410
Prepaid expenses	8,080	8,080
Total current assets	211,897	213,661
Restricted cash	833	833
Property and equipment, net	51,084	51,084
Goodwill	2,784	2,784
Other long-term assets, net	1,372	1,372
Total assets	$ 267,970	$ 269,734
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	39,486	39,486
Accrued liabilities	25,411	25,411
Capital lease obligations, current	6,445	6,445
Total current liabilities	71,342	71,342
Capital lease obligations, non-current	7,038	7,038
Convertible senior notes	84,468	84,468
Total liabilities	162,848	162,848
Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of March 31, 2005	3,259	3,259
Stockholders equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of March 31, 2005		
Common stock, $0.0001 par value, 100,000 shares authorized, 19,491 shares issued as of March 31, 2005	2	2
Additional paid-in capital	247,751	247,751
Accumulated deficit	(79,816)	(78,052)
Unearned stock-based compensation	(510)	(510)
Treasury stock, 31 shares at cost as of March 31, 2005	(65,337)	(65,337)
Accumulated other comprehensive loss	(227)	(227)
Total stockholders equity	101,863	103,627

Total liabilities, redeemable securities and stockholders equity	$	267,970	$	269,734

Consolidated Balance Sheets

(in thousands)

	As of December 31, 2004 As Previously Reported	As of December 31, 2004 As Restated
Assets		
Current assets:		
Cash and cash equivalents	$ 198,678	$ 198,678
Marketable securities	88,802	88,802
Cash, cash equivalents and marketable securities	287,480	287,480
Accounts receivable, net	5,715	5,715
Inventories, net	45,279	46,558
Prepaid inventory	12,322	12,322
Prepaid expenses	3,444	3,444
Total current assets	354,240	355,519
Restricted cash	1,602	1,602
Property and equipment, net	16,122	16,122
Goodwill	2,784	2,784
Other long-term assets, net	1,516	1,516
Total assets	$ 376,264	$ 377,543
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	64,060	64,060
Accrued liabilities	22,917	22,917
Capital lease obligations, current	595	595
Total current liabilities	87,572	87,572
Capital lease obligations, non-current	743	743
Convertible senior notes	116,251	116,251
Total liabilities	204,566	204,566
Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of December 31, 2004	3,166	3,166
Stockholders equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2004		
Common stock, $0.0001 par value, 100,000 shares authorized, 19,390 shares issued as of December 31, 2004	2	2
Additional paid-in capital	243,131	243,131
Accumulated deficit	(73,005)	(71,726)
Unearned stock-based compensation	(1,301)	(1,301)
Treasury stock, 35 shares at cost as of December 31, 2004	(100)	(100)
Accumulated other comprehensive loss	(195)	(195)
Total stockholders equity	168,532	169,811
Total liabilities, redeemable securities and stockholders equity	$ 376,264	$ 377,543

13

3. ACCOUNTING POLICIES

Derivative instruments

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), requires companies to recognize all of its derivative instruments, including certain derivative instruments embedded in other contracts, as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in an international operation. For derivatives designated as hedges, the changes in fair value are recorded in the balance sheet as an item in other comprehensive income. Changes in the fair value of derivatives not designated as hedges are recorded in the statement of operations. As of June 30, 2005, the Company had not designated any derivative instruments as hedges.

Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7 *Reporting on Advertising Costs* . As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place, and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) during the period customers are acquired; or 2) based on the number of clicks generated during a given period over the term of the contract. Advertising expense included in sales and marketing expenses totaled $6,391 and $14,084 during the three months ended June 30, 2004 and 2005, respectively, and $10,502 and $30,565 during the six months ended June 30, 2004 and 2005, respectively.

Recent accounting pronouncements

In March 2005, the Financial Accounting Standards Board (FASB) issued FIN 47 which clarifies guidance provided by Statement No. 143, Accounting for Asset Retirement Obligations. FIN 47 is effective for the Company no later than March 31, 2006. The adoption of FIN 47 is not expected to have a significant impact on the Company s financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004) *Share-Based Payment* (Statement 123R). This standard requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. The effective date is the first annual reporting period beginning after June 15, 2005. The Company is currently evaluating pricing models and the transition provisions of this standard and will begin expensing all stock-based compensation in the first quarter of 2006.

On March 29, 2005, the SEC published Staff Accounting Bulletin (SAB) No. 107, which provides the Staffs views on a variety of matters relating to the interaction between Statement 123R and certain Securities and Exchange Commission Rules and regulations. The Company is currently evaluating the provisions of the SAB and will implement it when the Company begins expensing stock options under Statement 123R in the first quarter of 2006.

In March 2004, the FASB issued EITF Issue No. 03-1 (EITF 03-1), *The Meaning of Other-than-Temporary Impairments and its Application to Certain Investments,* which provides new guidance for assessing impairment losses on investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however, the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company will evaluate the impact of EITF 03-1 once final guidance is issued.

On June 7, 2005, the FASB issued Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements (FAS 154). FAS 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. FAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. FAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of FAS 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

4. MARKETABLE SECURITIES

The Company s marketable securities consist of funds deposited into capital management accounts managed by two financial institutions at June 30, 2005 as follows:

	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agency securities	$ 36,099	$	$ (198)	$ 35,901
Corporate securities	800			800
Mortgage-backed securities	2,270		(5)	2,265
Foreign corporate securities	49,937		(278)	49,659
Total	$ 89,106	$	$ (481)	$ 88,625

All marketable securities mature between 2005 and 2029 and are classified as available-for-sale securities. Available-for-sale securities are classified as current as they are deemed available for use, if needed for current operations.

Derivative instruments

During the first quarter of 2005, the Company purchased $49,937 of Foreign Corporate Securities (Notes) which fully mature in November 2006. The Notes do not have a stated interest rate, but are structured to return the entire principal amount and a conditional coupon if held to maturity. The conditional coupon will provide a rate of return dependent on the performance of a basket of eight Asian currencies against the U.S. dollar. If the Company redeems the Notes prior to maturity, the Company may not realize the full amount of its initial investment. At June 30, 2005, the Notes had a fair value of $49,659.

Under SFAS No. 133, the Notes are considered to be derivative financial instruments and are marked to market quarterly. Any unrealized gain or loss based on the quarterly mark-to-market valuation will be recorded in the income statement as a component of interest income. The impact of the Notes mark-to-market valuation resulted in a gain of $66 for the quarter ended June 30, 2005, and a loss of $278 for the six months ended June 30, 2005.

The Company purchased the Notes to manage its foreign currency risks related to the strengthening of Asian currencies compared to the U.S. dollar, which would reduce the inventory purchasing power of the Company in Asia. However, the Company determined that the Notes did not qualify as hedging derivative instruments. Nevertheless, management believes that such instruments are useful in managing the Company s associated risk.

5. OTHER COMPREHENSIVE LOSS

The Company follows SFAS No. 130, *Reporting Comprehensive Income.* This Statement establishes requirements for reporting comprehensive income and its components. The Company s comprehensive loss for the three and six months ended June 30, 2004 and 2005 is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2004 (Restated)	**2005 (Restated)**	**2004 (Restated)**	**2005 (Restated)**
Net loss	$ (2,181)	$ (1,923)	$ (4,434)	$ (6,233)
Net unrealized gain (loss) on marketable securities	(81)	321	(62)	(6)
Foreign currency translation adjustment	6	(8)	5	(26)
Comprehensive loss	$ (2,256)	$ (1,610)	$ (4,491)	$ (6,265)

6. NET LOSS PER SHARE

Basic 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 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, composed of incremental common shares issuable upon the exercise of stock options, warrants and convertible senior notes, are included in the calculation of diluted net loss per share to the extent such shares are dilutive. During the three and six month periods ended June 30, 2004 and 2005, the effects of outstanding stock options, warrants and convertible senior notes were antidilutive and, accordingly, have been excluded from diluted loss per share. There were 1,493 options and 446 warrants outstanding at June 30, 2005. As of June 30, 2005, the Company had $87,000 of convertible senior notes outstanding (Note 12), which could potentially convert into 1,154 shares of common stock in the aggregate.

7. BUSINESS SEGMENTS

Segment information has been prepared in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information. There were no inter-segment sales or transfers during the three or six-month periods ended June 30, 2004 or 2005. The Company evaluates the performance of its segments and allocates resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three and six months ended June 30, 2004 and 2005:

	Three months ended June 30,			Six months ended June 30,		
	Direct operations	Fulfillment partner operations	Consolidated	Direct operations	Fulfillment partner operations	Consolidated
2004 (Restated)						
Revenue	$ 41,113	$ 46,679	$ 87,792	$ 79,693	$ 90,177	$ 169,870
Cost of goods sold	36,645	41,114	77,759	71,504	79,907	151,411
Gross profit	$ 4,468	$ 5,565	10,033	$ 8,189	$ 10,270	18,459
Operating expenses			(12,295)			(23,058)
Other income (expense), net			81			165
Net loss			$ (2,181)			$ (4,434)

16

2005 (Restated)												
Revenue	$	60,064	$	90,574	$	150,638	$	127,948	$	188,571	$	316,519
Cost of goods sold		51,562		76,375		127,937		109,822		159,232		269,054
Gross profit	$	8,502	$	14,199		22,701	$	18,126	$	29,339		47,465
Operating expenses						(28,173)						(56,446)
Other income, net						3,549						2,748
Net loss					$	(1,923)					$	(6,233)

The direct segment includes revenues, direct costs, and allocations associated with sales fulfilled from our warehouses. Costs for this segment include product costs, inbound 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 the Company s third party fulfillment partner sales and are earned from selling the merchandise of third parties over the Company s Websites. Costs for this segment include product costs, warehousing and fulfillment costs, credit card fees and customer service costs. This segment also includes revenues and direct costs associated with our on-line auctions and travel businesses.

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

For the three and six-month periods ended June 30, 2004 and 2005, over 99% of sales were made to customers in the United States of America. No individual geographical area accounted for more than 10% of net sales in any of the periods presented. At December 31, 2004 and June 30, 2005, all of the Company s fixed assets were located in the United States of America.

8. PUBLIC OFFERINGS

In June 2004, the Company closed its second follow-on public offering, pursuant to which it sold 1,300 shares of common stock, with proceeds to the Company of approximately $37,857, net of $405 of issuance costs.

In November 2004, the Company closed an additional follow-on public offering, pursuant to which it sold 1,380 shares of common stock, with proceeds to the Company of approximately $75,207, net of $215 of issuance costs. Concurrently in November 2004, the Company issued convertible senior notes pursuant to which it received $116,199, net of $3,801 of initial purchaser s discount and debt issuance costs.

9. STOCK-BASED COMPENSATION

The Company measures compensation expense to employees for its equity incentive plan using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and provides pro forma disclosures of net income as if the fair value based method prescribed by Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation,* had been applied. The following table provides a reconciliation of net loss to pro forma net loss as if the fair value method had been applied to all awards.

	Three months ended June 30,				Six months ended June 30,			
		2004 (Restated)		2005 (Restated)		2004 (Restated)		2005 (Restated)
Net loss, as reported	$	(2,181)	$	(1,923)	$	(4,434)	$	(6,233)
Add: Stock-based employee compensation expense included in reported net income		123		53		258		73
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards		(835)		(1,011)		(1,944)		(1,915)
Pro forma net loss	$	(2,893)	$	(2,881)	$	(6,120)	$	(8,075)
Net loss per common share								
Basic and diluted - as reported	$	(0.13)	$	(0.10)	$	(0.26)	$	(0.32)
Basic and diluted - pro forma	$	(0.17)	$	(0.15)	$	(0.36)	$	(0.41)

The fair value of options granted is estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. We use the historical stock price volatility of our common stock over the most recent period that is generally commensurate with the expected option life as the basis for estimating stock price volatility. For options granted during the three months ended June 30, 2004 and 2005, the historical stock price volatility used was based on a daily stock price observation, using the closing price, which resulted in an expected stock price volatility of 101% and 80%, for those respective periods. For purpose of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods. Effective January 1, 2006, the Company will record stock compensation expense in accordance with FAS 123R.

10. SHARE BUYBACK PROGRAM

During January 2005, the Company s Board of Directors authorized a stock repurchase program under which the Company was authorized to repurchase up to $50,000 of its common stock through December 31, 2007. On April 26, 2005, the Board of Directors increased the amount of the stock buyback program to $100,000. Additionally, on June 14, 2005, the Board of Directors authorized an amendment of its three-year stock repurchase program to include the repurchase of its Convertible Senior Notes.

During 2005, the Company entered into several purchased call options, pursuant to which the Company could have been required to purchase up to 1,250 shares of its common stock at certain settlement dates during the quarter ended June 30, 2005. In connection with these repurchase transactions; the Company paid approximately $47,507, which has been recorded in shareholders equity in the consolidated balance sheet.

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

Under the buyback program, we repurchased approximately 665 shares of our common stock in open market transactions for $24,134 during the six months ended June 30, 2005. In addition, approximately 1,000 shares of common stock were acquired as a result of the settlement of $41,121 of structured stock repurchase transactions during the six months ended June 30, 2005. The purchased call options that did not settle in stock, settled in cash totaling $7,937. The Company recorded a receivable in the consolidated balance sheet for the $7,937 received by the Company in

July 2005.

11. BORROWINGS

In December 2004, the Company entered into an amendment to a credit agreement (Amended Credit Agreement) with Wells Fargo Bank, National Association. The existing credit agreement (originally executed in February 2004) provided the Company with a revolving line of credit for the purpose of issuing up to $10,000 of letters of credit for the purchase of inventory. The Amended Credit Agreement provided a revolving line of credit to the Company of up to $30,000 (subsequently reduced as described below) and expires December 31, 2005. The Company has an option to renew the Amended Credit Agreement annually. Included in the $30,000 Amended Credit Agreement was a $15,000 sub-limit for a revolving line of credit which the Company used to obtain letters of credit to support inventory purchases.

In June 2005, we entered into a fifth amendment to the credit agreement (Fifth Amended Credit Agreement). The Fifth Amended Credit Agreement reduced the revolving line of credit from $30,000 to $20,000. The $15,000 sub-limit which we use to obtain letters of credit remains unchanged. At June 30, 2005 the issuing bank or an affiliate of the bank had letters of credit totaling $11,214 issued on our behalf under this facility.

Interest on borrowings is payable monthly and accrues at either (i) one-half of one percentage point (0.50%) above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. Unpaid principal, together with accrued and unpaid interest is due on the maturity date, December 31, 2005. Borrowings under the facility are collateralized by the Company s cash and marketable securities deposited at Wells Fargo or its affiliates, and the Company is required to maintain balances with Wells Fargo or its affiliates of up to $21,100 in order to have the full amount of the credit facility available. At June 30, 2005, there was no outstanding balance on this line.

The Fifth Amended Credit Agreement requires the Company to comply with certain covenants, including restrictions on mergers, business combinations or transfer of assets. The Company was in compliance with these covenants at June 30, 2005.

Capital leases

The Company leases certain software and computer equipment under three non-cancelable capital leases that expire at various dates through 2008. The Company expects that in the normal course of business the leases will expire. Software and equipment acquired relating to the capital leases were $16,335 and $1,835 at June 30, 2005 and December 31, 2004, respectively, with accumulated depreciation of $1,833 and $395 for those respective periods. Depreciation of assets recorded under capital leases was $1,426 and zero for the six months ended June 30, 2005 and 2004, respectively.

Future minimum lease payments under capital leases are as follows:

Year Ending June 30,		
2006	$	7,192
2007		4,768
2008		3,001

2009		
2010		
Total minimum lease payments		14,961
Less: amount representing interest		(1,478)
Present value of capital lease obligations		13,483
Less: current portion		(6,445)
Capital lease obligations, non-current	$	7,038

12. 3.75% CONVERTIBLE SENIOR NOTES

In November 2004, the Company completed an offering of $120,000 of 3.75% Convertible Senior Notes (the Senior Notes). This includes $20,000 of additional Senior Notes issued to the initial purchaser upon exercise of its 30-day purchase option to cover over-allotments. Proceeds to the Company were $116,199, net of $3,801 of initial purchaser s discount and debt issuance costs. The discount and debt issuance costs are being amortized using the straight-line method which approximates the interest method. During the three and six months ended June 30, 2005, the Company recorded amortization of discount and debt issuance costs related to this offering totaling $116 and $423, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year, beginning June 1, 2005. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

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

The indenture governing the Senior Notes requires the Company to comply with certain affirmative covenants, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. The Company was in compliance with these covenants at June 30, 2005.

In June 2005, under the Share Buyback Program (see Note 10), the Company retired $33,000 of its 3.75% Convertible Senior Notes (the «Senior Notes»), which were due on December 1, 2011 for $27,935 in cash. As a result of the note retirement, the Company recognized a net gain of $4,170, net of associated unamortized discount cost of $960, in other income in the consolidated statements of operations. As of June 30, 2005, $87,000 of the Senior Notes remained outstanding.

13. COMMITMENTS AND CONTINGENCIES

Through July 2005, the Company leased 43 square feet of office space under an operating lease which was originally scheduled to expire in January 2007. However, effective July 2005 this lease was terminated and replaced with a lease for a new office building in the Old Mill Corporate Center III in Salt Lake City, Utah. Pursuant to this agreement, the Company will lease approximately 143 rentable square feet for a term of ten years beginning July 2005. The Company and Old Mill Corporate Center III, LLC (the Lessor) have entered into a Tenant Improvement Agreement (the OMIII Agreement) relating to the office building. The OMIII Agreement sets forth the terms on which the Company will pay the costs of certain improvements to the leased office space. The amount of the costs is estimated to be approximately $2,000.

The OMIII Agreement requires the Company to reimburse the Lessor for the amount of the costs within thirty days after presentation of invoices or written requests for reimbursement. The OMIII Agreement also requires the Company to provide either a cash deposit or a letter of credit in the amount of $500 to the Lessor to provide funds for the removal of the improvements upon the termination of the lease. The Company issued a letter of credit for $500 to the Lessor.

The Company also leases 354 and 143 square feet for its warehouse facilities in Utah and Indiana, respectively, under operating leases which expire in August 2012.

In June 2005, the Company entered into a non-cancelable operating lease for certain computer equipment expiring in the next three years. It is expected that such leases will be renewed by exercising purchase options or replaced by leases of other computer equipment.

Minimum future payments under these leases are as follows:

Twelve Months Ending June 30,		
2006	$	4,939
2007		6,242
2008		7,193
2009		7,548
2010		7,756
Thereafter		40,125
	$	73,803

Rental expense for operating leases totaled $392 and $498 for the three months ended June 30, 2004 and 2005, respectively, and $783 and $998 for the six months ended June 30, 2004 and 2005, respectively.

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

In October 2003, Tiffany (NJ) Inc. and Tiffany and Company filed a complaint against the Company in the United States District Court for the Southern District of New York alleging that the Company had distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. The complaint seeks statutory and other damages in an unspecified amount and injunctive relief. In January and February 2005, Tiffany (NJ) Inc. and Tiffany and Company filed five additional complaints against the Company in the United States District Court for the Southern District of New York alleging that the Company had distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. These complaints also seek statutory and other damages in an unspecified amount and injunctive relief. Although the Company has filed answers to these complaints and the Company believes it has defenses to the allegations and intends to pursue them vigorously, the Company does not have sufficient information to assess the validity of the claims or the amount of potential damages alleged in these suits.

In September 2004, the Company received a letter from BTG International Inc. claiming that certain of its business practices and online marketing information technology systems infringe patents owned by BTG. On September 14, 2004, without engaging in any meaningful discussion or negotiation with the Company, BTG filed a complaint in the United States District Court of Delaware alleging that certain of the Company s business practices and online marketing information technology systems infringe a single patent owned by BTG. On October 21, 2004, the Company filed an answer denying the material allegations in BTG s claims. Although the Company has filed an answer and believes it has defenses to the allegations and intends to pursue them vigorously, the BTG lawsuit is in the discovery stage, and the Company does not have sufficient information to assess the validity of the claims or the amount of potential damages.

14. INDEMNIFICATIONS AND GUARANTEES

During its normal course of business, the Company has made certain indemnities, commitments, and guarantees under which it may be required to make payments in relation to certain transactions. 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 directors and officers of the Company 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 the Company could be obligated to make. As such, the Company is unable to estimate with any reasonableness its potential exposure under these items. The Company has not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. The Company does, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable. The Company carries specific and general liability insurance policies that the Company believes would, in most circumstances, provide some, if not total recourse to any claims arising from these indemnifications.

15. VARIABLE INTEREST ENTITY

In August 2004, the Company entered into an agreement which allows the Company to lend up to $10,000 to an entity for the purpose of buying inventory, primarily to supply a new category within our jewelry store which allows customers purchasing diamond rings to select both a specific diamond and ring setting. In November 2004, the Company loaned the entity $8,400. The promissory note bears interest at 3.75% per annum. The Company is also entitled to receive fifty percent (50%) of any profits of the entity. Interest is due and payable quarterly on the fifteenth day of February, May, August and November, commencing on November 15, 2004 until the due date of November 30, 2006, on which all principal and interest accrued and unpaid thereon, shall be due and payable. The promissory note is collateralized by all of the assets of the entity.

The Company has a ten year option to purchase (Purchase Option) 50% of the ownership and voting interest of the entity. The exercise price of the Purchase Option is the sum of (a) one thousand dollars, and (b) $3,000, which may be paid, at the Company s election, in cash or by the forgiveness of $3,000 of the entity s indebtedness to the Company.

The entity was evaluated in accordance with FASB Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51,* and it was determined to be a variable interest entity for which the Company was determined to be the primary beneficiary. As such, the financial statements of the entity are consolidated into the financial statements of the Company.

The carrying amount and classification of the consolidated assets that are collateral for the entity s obligations include:

		June 30, 2005
Cash	$	166
Accounts receivable		61
Inventory		7,737
Prepaid expenses		52
Property and equipment		250
Total assets	$	8,266

16. SUBSEQUENT EVENTS

On July 1, 2005, the Company acquired all of the outstanding capital stock of Ski West, Inc. (Ski West) for an aggregate of $25,000 (plus potential earn out payments based on operating results for the next four years), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005 among the Company, Ski West, and all of the shareholders of Ski West. Effective upon the closing, Ski West became a wholly-owned subsidiary of the Company. Ski West is a rapidly growing, on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel offerings are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises.

On July 1, 2005, the Company and OMTek, LLC («OMTek») executed a Colocation Center Agreement («Agreement») for a portion of the first floor in the Old Mill Corporation Center II building in Salt Lake City, Utah (the «Building»). Pursuant to this Agreement, the Company will lease approximately 11 rentable square feet for a term of ten years, beginning on the date of occupancy which is anticipated to be during the first quarter of 2006. The base rent is $198 per month, and escalates at the rate of 3% per year. During the first three years of this Agreement, OMTek will issue rent credits to the Company of $1,500, $1,000, and $500, respectively. OMTek also agreed to reimburse the Company for moving costs actually incurred up to $250. OMTek also agreed to give the Company a rental credit toward cost over-runs due to upgrades in electrical or other equipment of up to $1,000 credited to the Company at the end of the lease.

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

Special Note Regarding Forward Looking Statements

In addition to historical information, this Quarterly Report on Form 10-Q/A contains forward-looking statements. These statements relate to our, and in some cases our customers or other third parties , future plans, objectives, expectations, intentions and financial performance and the assumptions that underlie these statements. These forward-looking statements include, but are not limited to, statements regarding the following: our beliefs and expectations regarding the seasonality of our direct and fulfillment partner revenue; our beliefs regarding the sufficiency of our capital resources; planned distribution and order fulfillment capabilities; our beliefs, intentions and expectations regarding improvements of our order processing systems and capabilities; our intentions regarding the development of enhanced technologies and features; our intentions regarding the expansion of our customer service capabilities; our beliefs and intentions regarding improvements to our general and administrative functions; our beliefs and intentions regarding enhancements to our sales and marketing activities; our beliefs regarding the potential for growth in our customer base; our beliefs and intentions regarding our expansion into new markets, including international markets; our beliefs and intentions about entering into agreements to provide products and services to retail chains and other businesses; our belief regarding potential development of new Websites; our beliefs, intentions and expectations regarding promotion of new or complimentary products and sales formats; our beliefs, intentions and expectations regarding the expansion of our product and service offerings; our beliefs and intentions regarding expanding our market presence through relationships with third parties; our beliefs regarding the pursuit of complimentary businesses and technologies; our beliefs regarding the adequacy of our insurance coverage; our beliefs, intentions and expectations regarding litigation matters and other legal proceedings, and our defenses and responses to such matters; our beliefs and expectations regarding our existing cash and cash equivalents, cash requirements and sufficiency of capital; and our beliefs and expectations regarding interest rate risk, our investment activities and the effect of changes in interest rates.

These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties please see the Factors That May Affect Future Results section of this report. 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.

Restatement

As discussed in Note 2 to the financial statements, the financial statements for the quarters ended June 30, 2004 and 2005 and the related notes thereto contained in this Amendment No. 1 to the Company s Quarterly Report on Form 10-Q/A for the quarters ended June 30, 2004 and 2005 have been restated in order to properly reflect the capitalization of inbound freight as a component of inventory rather than as a period cost. The cumulative effect of the adjustments for all fiscal years prior to 2002 is to reduce the reported accumulated deficit and to increase inventory by $239,000. The effect of the adjustments on the Consolidated Results of Operations for the years ended December 31, 2002, 2003 and 2004 is to reduce net loss by $241,000, $339,000 and $462,000, respectively. The effect of the adjustment on the Consolidated Results of Operations for the three-month periods ended June 30, 2004 and 2005 is to decrease net loss by $141,000 and $592,000, respectively. All amounts in Management s Discussion and Analysis of Financial Condition and Results of Operation have been adjusted, as appropriate, for the effects of the restatement.

A more complete discussion of the restatement can be found in Item 4.02(a) of the Company s Current Report on Form 8-K filed with the Commission on February 27, 2006.

Overview

We are an online closeout retailer offering discount brand name merchandise, including bed-and-bath goods, home décor, kitchenware, watches, jewelry, electronics, sporting goods, apparel, designer accessories and travel, among other products. We also sell books, magazines, CD s, DVD s, videocassettes and video games (BMV). Our company, based in Salt Lake City, Utah, was founded in 1997, and we launched our first Website through which customers could purchase products in March 1999. In September 2004, we launched an online auction site as part of our Website an online marketplace for the buying and selling of goods between our customers.

Our revenue is comprised of direct revenue and fulfillment partner revenue. During the quarter ended June 30, 2005, no single customer accounted for more than 1% of our total revenue. Direct revenue includes sales made to individual consumers and businesses, which are fulfilled from our warehouse in Salt Lake City, Utah or our outsourced warehouse located in Plainfield, Indiana.

Our fulfillment partner revenue is generated when we sell merchandise of other retailers, cataloguers or manufacturers (fulfillment partners) through our Website. We are considered to be the primary obligor for the majority of these sales transactions, and we assume the risk of loss on the returned items. As a consequence, we record revenue from the majority of these sales transactions involving our fulfillment partners (excluding travel products) on a gross basis. Similar to our direct segment, fulfillment partner products are available to both consumers and businesses through our Club O frequent buyers club program and our Club O Gold bulk purchase program. Our use of the term partner or fulfillment partner does not mean that we have formed any legal partnerships with any of our fulfillment partners.

During the fourth quarter of 2003, we added a discount travel store to our Website. We used fulfillment partners to supply the travel products and services (flights, hotels, rental cars, etc.). For the first and second quarters of 2004, our revenues from the Travel department were insignificant. During May of 2004, our travel store was closed so we could work to make improvements to the travel product offerings. In January 2005, we re-opened the travel store on our Website. We currently offer cruise and vacation packages, and we plan to offer additional travel services later this year. For the products and services sold in our travel store, we did not have inventory risk or pricing control, and did not provide customer service. Therefore, for these sales we are not considered to be the primary obligor, and record only our commission as revenue. On July 1, 2005, the Company acquired all of the outstanding capital stock of Ski West, Inc. (Ski West) for an aggregate of $25 million (plus potential earn out payment s based on operating results for the next four years), subject to reduction under certain circumstances, pursuant to the Stock Purchase Agreement dated June 24, 2005 among the Company, Ski West, and all of the shareholders of Ski West. As a result, effective upon the closing, Ski West became a wholly-owned subsidiary of the Company. Ski West is a rapidly growing, on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel offerings are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises.

During September 2004, we added an online auction service to our Website. Our auction tab allows sellers to list items for sale, buyers to bid on items of interest, and users to browse through listed items online. We are not the seller of the items sold on the auction site and we have no control over the pricing of those items. Therefore, for these sales we record only our listing fees and commissions for items sold as revenue. Unless otherwise indicated or required by the context, the discussion herein of our financial statements, accounting policies and related matters, pertains to our shopping site and not necessarily to our auction site. Revenue from our auction business is included in the fulfillment partner segment, as it is not significant enough to separate out as its own segment at this early stage of the business.

Our revenue from sales on our shopping site is recorded net of returns, coupons and other discounts. Our returns policy for all products other than those sold in our Electronics and Computers department provides for a $4.95 restocking fee and the provision that we will not accept product returns initiated more than twenty days after the shipment date. We charge a 15% restocking fee (instead of the $4.95 restocking fee) on all items returned for non-defective reasons from the Electronics and Computers department.

Cost of goods sold consists of the cost of the product, as well as inbound and outbound freight, fixed warehouse costs, warehouse handling costs, credit card fees, and customer service costs. Within the direct revenue channel, our gross margins on sales through our Club O frequent buyers club, our Club O Gold bulk purchases program and our BMV products tend to be lower than margins on our consumer sales, and our overall gross margins will be impacted by the blend of Club O, Club O Gold, and BMV sales as a percentage of our direct revenue.

Sales and marketing expenses consist primarily of advertising, public relations and promotional expenditures, as well as payroll and related expenses for personnel engaged in marketing and selling activities. Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and our offline national radio and television advertising. For the three months ended June 30, 2004 and 2005, our advertising expenses totaled approximately $6.4 million and $14.1 million, respectively, representing 97% of sales and marketing expenses for both those respective periods. For the six months ended June 30, 2004 and 2005, our advertising expenses totaled approximately $10.5 million and $30.6 million, respectively, representing 95% and 98% of sales and marketing expenses for those respective periods. We expect our sales and marketing expenses to increase in future periods on an absolute dollar basis as we expect to continue to increase our advertising efforts.

Technology expenses consist of wages and benefits for technology personnel, rents, depreciation and amortization related to software and computer equipment.

General and administrative expenses consist of wages and benefits for executive, accounting, merchandising and administrative personnel, rents and utilities, travel and entertainment, depreciation and amortization and other general corporate expenses.

Goodwill is not amortized, but is evaluated at least annually for impairment. There were no impairments of goodwill during the six months ended June 30, 2004 and 2005.

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

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

Executive Commentary

The following 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 Operation, as well as our audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2004 and our unaudited financial statements included in this Quarterly Report on Form 10-Q/Aas well as the discussion of our business and risk factors and other information included elsewhere in this Form 10-Q/A. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements included in this Form 10-Q/A.

Commentary Growth in Revenue. Total revenue was $150.6 million for the three-month period ended June 30, 2005, a 72% increase from the $87.8 million recorded during the same period in 2004. For the six-month period ended June 30, 2005, total revenue grew 86% to $316.5 million from $169.9 million recorded in the same period in 2004.

Commentary Improved Gross Margins and Growth in Gross Profits. Gross margins increased from 11.4% in the second quarter of 2004 to 15.1% during the same period in 2005. For the six-month periods ended June 30, 2004 and 2005, margins improved from 10.9% to 15.0%, respectively.

The improvements in gross margins are a result of the progress we achieved and efficiencies gained in several areas over the last six quarters. In particular, we believe our buying has become more effective as we continue to grow, allowing us to make larger inventory purchases and obtain more favorable pricing. Our total cost per package shipped has decreased due to better process management and lower packaging costs, and as a result of increased sales volumes. As a result of increased volumes and improved vendor relationships, we have obtained decreases in outbound shipping costs. Additionally, we have also made improvements to the cost of processing returns, customer service costs and credit card fees.

In the second quarter of 2005, we made slight efficiency gains in gross margins; and management continues to believe that additional improvements can be made in shopping margins; in particular as a result of technology projects currently being implemented.

Commentary Marketing. Sales and marketing expenses totaled $6.6 million and $14.5 million for the quarters ended June 30, 2004 and 2005, respectively, representing an increase of 119%. For those respective three-month periods sales and marketing expenses equaled 8% and 10% of total revenue. For the six months ended June 30, 2004 and 2005, sales and marketing expenses increased 185%, from $11 million to $31.3 million, respectively. As a percentage of total revenue, sales and marketing expenses represent 6% and 10% for the six months ended June 30, 2004 and 2005, respectively.

Management believes that our extensive marketing efforts directly resulted in a significant increase in Website traffic (52% year over year for the second quarter, according to Nielsen Net Ratings). However, some of the increase has been in lower-converting traffic as well as traffic to our auctions tab. We did see some improvements in marketing efficiency in the second quarter, as marketing spend as a percentage of revenue decreased to 9.6% from 10.1% of total revenue in the first quarter. Our target at current growth rates is to spend between 8% to 9% of total revenue.

Commentary Technology expenses . Technology costs increased 233%, from $1.8 million in the second quarter of 2004 to $6.1 million in second quarter of 2005. For the six months ended June 30, 2004 and 2005, technology costs increased 218%, from $3.2 million to $10.2 million, respectively.

We have incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for the next growth period of our lifecycle. The increase in absolute dollars was primarily attributable to costs and depreciation associated with infrastructure, including expansion of corporate systems, such as Oracle licenses and development. The increase in technology expenses also included the costs associated with the strategic projects of 2005, namely, completion our auctions tab, reconstruction of our travel website, development of our search engine and the data warehouse and customer analytics system.

Commentary General and Administrative Expenses. General and administrative expenses increased 101% from $3.7 million in the second quarter of 2004 to $7.5 million during the second quarter of 2005, representing 4% and 5% of total revenue, respectively. General and administrative expenses increased 72% from $8.6 million during the six month period ending June 30, 2004 to $14.9 million in the same period ended June 30, 2005, representing 5% of total revenue for each period.

The increase in general and administrative expenses relates to the increase in staffing, primarily in merchandising and finance. We also expect an additional increase of approximately $1 million quarterly for increased rent as a result of the relocation of the corporate office in July 2005.

Commentary Strategic Projects. Following is a brief update on some of our recent strategic projects:

1) Auctions Our Auctions continue what we believe to be a robust start, as we are able to maintain approximately 1% of the listings of eBay s domestic business. We have found goodwill and support in the serious auction community, which is guiding us regarding the features and programs it wants us to develop.

2) Propeller Our collaborative filtering initiative is live and we believe it is providing some sales lift. However, it still requires fine tuning, and we believe it will be more fully functional by the end of the third quarter.

3) Travel While cruises and vacation packages are live, the date for completion of the tab (including other services such as flights, hotels, car rentals, etc.) slid from April to September. The addition of Ski West, Inc will help speed the progression of our Travel tab.

4) Design Your Own Jewelry We have added the ability on our website for a customer to design an engagement ring to their own specifications. This department ran at a small loss in the first and second quarters, and we expect that loss to continue for at least one or two more quarters.

Critical Accounting Policies and Estimates

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

revenue recognition;

estimating valuation allowances and accrued liabilities, specifically, the reserve for returns, the allowance for doubtful accounts and the allowance for obsolete and damaged inventory;

accounting for income taxes

valuation of long-lived and intangible assets and goodwill; and

derivative instruments

Revenue recognition. We derive our revenue from three sources: (i) direct revenue, which consists of merchandise sales made to consumers and businesses that are fulfilled from our warehouse; (ii) fulfillment partner revenue, which consists of revenue from the sale of merchandise shipped by fulfillment partners directly to consumers and other businesses, as well as fee revenue collected from the products listed and sold through the auction tab of our Website; and (iii) commission revenue from our auctions and travel operations. All sources of revenue are recorded net of returns, coupons redeemed by customers, and other discounts. Revenues from our auction and travel services were not material in 2004 or 2005 and therefore are included in fulfillment partner revenue.

We record revenue from the majority of these sales transactions involving our fulfillment partners (excluding auction and travel products) on a gross basis. Similar to our direct revenue segment, fulfillment partner products are available to both consumers and businesses through our Club O frequent buyers club and our Club O Gold bulk purchase program.

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

Reserve for returns, allowance for doubtful accounts and the allowance for obsolete and damaged inventory. Our management must make estimates of potential future product returns related to current period revenue. Management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. The reserve for returns was $2.8 million and $1.6 million as of December 31, 2004 and June 30, 2005, respectively.

From time to time, we may grant credit to certain of our business customers on normal credit terms. We perform ongoing credit evaluations of our customers financial condition and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectibility of all accounts receivable. We maintained an allowance for doubtful accounts receivable of $750,000 and $886,000 as of December 31, 2004 and June 30, 2005, respectively.

We write down our inventory for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Our inventory balance was $46.6 million, net of allowance for obsolescence or damaged inventory of $1.3 million as of December 31, 2004. At June 30, 2005, our inventory balance was $61.5 million, net of reserve for obsolescence or damaged inventory of $1.3 million.

Accounting for income taxes. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. As of December 31, 2004 and June 30, 2005, we have recorded a full valuation allowance of $27.4 million and $30.1 million, respectively, against our net deferred tax asset balance due to uncertainties related to our deferred tax assets as a result of our history of operating losses. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

Valuation of long-lived and intangible assets and goodwill. Under SFAS 142, Goodwill and Other Intangible Assets, goodwill is no longer amortized, but must be tested for impairment at least annually. Other long-lived assets must also be evaluated for impairment when management believes that an asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the asset that may not be reflected in an asset s current carrying value, thereby possibly requiring an impairment charge in the future. There were no impairments of goodwill or long-lived assets during the six months ended June 30, 2005. Goodwill totaled $2.8 million as of December 31, 2004 and June 30, 2005.

Derivative instruments. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), requires companies to recognize all of its derivative instruments, including certain derivative instruments embedded in other contracts, as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in an international operation. For derivatives designated as hedges, the changes in fair value are recorded in the balance sheet as an item in other comprehensive income. Changes in the fair value of derivatives not designated as hedges are recorded in the statement of operations. As of June 30, 2005, we have not designated any derivative instruments as hedges.

Results of Operations 2004 compared to 2005

Revenue

Total revenue was $150.6 million for the three-month period ended June 30, 2005, a 72% increase from the $87.8 million recorded in the same period in 2004. During this same period, direct revenue increased from $41.1 million to $60.1 million, a 46% growth. Fulfillment partner revenue also grew from $46.7 million in the second quarter of 2004 to $90.6 million, representing growth of 94%. For the six-month period ended June 30, 2005, total revenue grew 86% to $316.5 million from $169.9 million recorded in the same period in 2004. Also during the same six-month period, direct revenue grew 61% to $127.9 million in 2005 from $79.7 million in 2004. Fulfillment revenue grew 109.1% to $188.6 million from $90.2 million recorded in 2004.

Gross bookings totaled $96.6 million and $173.9 million for the quarters ended June 30, 2004 and 2005, respectively, representing an increase of 80%. For the six-month periods ended June 30, 2004 and 2005, gross bookings totaled $190.0 million and $358.0 million, respectively, representing an increase of 88%. Gross bookings differ from GAAP revenue in that gross bookings represent the gross sales price of goods sold by the Company before returns and sales discounts.

Our total revenue for the three and six month periods ended June 30, 2005, increased as a result of our normal online marketing efforts as well as offline efforts through channels such as nation-wide television, print and radio advertising campaigns. The increase in total revenue is also a reflection of our ability to acquire new customers from our marketing efforts, as evidenced by the addition of 611,000 new customers during the second quarter of 2005 compared to 414,000 new customers in the same quarter of 2004, an increase of 48%. In addition, total revenue benefited from discounted shipping promotions run during the months of March and May.

Gross Margins

Cost of goods sold increased in absolute dollars, from $77.8 million during the second quarter of 2004 to $127.9 million in same quarter of 2005. In comparing the second quarters of 2004 and 2005, total revenue increased 72%, from $87.8 million to $150.6 million, while gross profit dollars increased 126%, from $10.0 million to $22.7 million in the same periods. As a percent of total revenue, cost of goods sold decreased from 88.6% to 84.9% for those respective periods resulting in gross margins of 11.4% and 15.1% for the quarters ended June 30, 2004 and 2005, respectively.

For the six-month periods ended June 30, 2004 and 2005, cost of goods totaled $151.4 million and $269.1 million, respectively, representing improved margins from 10.9% to 15.0%, respectively. In dollar terms, gross margins totaled $18.5 million and $47.5 million for the six month periods ended June 30, 2004 and 2005, respectively, a 157% increase.

Gross profits for our direct operations increased from $4.5 million for the quarter ended June 30, 2004 to $8.5 million recorded during the same period in 2005. For our direct operations, gross profit dollars for the quarter ended June 30, 2005 increased 90% on a year-over-year basis while direct revenue increased 46% from $41.1 million in the quarter ended June 30, 2004 to $60.1 million in the same quarter ended June 30, 2005. Gross profits for our direct operations, as a percentage of direct revenue, increased from 10.9% during the second quarter of 2004 to 14.2% during the same quarter of 2005.

For the six-month periods ended June 30, 2004 and 2005, gross profit dollars for our direct operations totaled $8.2 million and $18.1 million, representing gross margins of 10.3% and 14.2%, respectively. Gross profit dollars for the six months ended June 30, 2005 increased 121% over the same period in 2004 while sales increased 61%, from $79.7 million to $127.9 million for the same comparative periods.

The improvements in gross margins are a result of the progress we achieved and efficiencies gained in several areas, especially in the first quarter of 2005. We believe our buying has become more effective as we continue to grow, allowing us to make larger inventory purchases and obtain more favorable pricing. In addition, we have made improvements to our fulfillment costs. Fulfillment costs during the second quarters of 2004 and 2005 were $6.4 million and $10.8 million or 7% of total revenue for those respective periods. For the first six months of 2004 and 2005, fulfillment costs were $13.2 million and $22.7 million, respectively, representing 8% and 7% of total revenue for those respective periods. Fulfillment costs include warehousing (excluding packaging costs), customer service costs and credit card fees. In addition, as a result of increased volumes and improved vendor relationships, we have obtained decreases in outbound shipping costs.

Our fulfillment partner operations generated gross profits of $5.6 million and $14.2 million for the quarters ended June 30, 2004 and 2005, respectively, an increase of 155%. Gross profits for our fulfillment partner operations, as a percentage of fulfillment partner revenue increased from 12% during the second quarter of 2004 to 16% during the same quarter of 2005. For the six months ended June 30, 2004 and 2005, gross profits from our fulfillment partner operations increased 186% from $10.3 million to $29.3 million, representing gross margins of 11.4% and 15.6%, respectively.

The increase in the gross profit dollars for our fulfillment partner operations was due to the general growth of the consumer business during the year, and an increase in the number of fulfillment partner products offered on our Websites. The increase in gross margins for our fulfillment partner operations is largely due to improvements in buying, customer service costs and credit card fees, as well as a decrease in BMV sales from 13.0% of fulfillment partner revenue during the first and second quarter of 2004 to 10.8% during the same quarters of 2005.

Gross margins for BMV products have historically been much lower than those of other product categories; however, we did make improvements in the BMV margins in 2005, which, in turn, increased the gross profit margin for the overall fulfillment partner operations.

Operating expenses

Sales and marketing. Sales and marketing expenses totaled $6.6 million and $14.5 million for the quarters ended June 30, 2004 and 2005, respectively, representing an increase of 119%. For the three month periods ended June 30, 2004 and 2005, sales and marketing expenses equaled 8% and 10%, respectively, of quarterly total revenue. For the six months ended June 30, 2004 and 2005, sales and marketing expenses increased 185%, from $11.0 million to $31.3 million, respectively. As a percentage of total revenue, sales and marketing expenses represent 6% and 10% for the six months ended June 30, 2004 and 2005, respectively.

Overall online marketing spend has increased as a result of increased online marketing rates during 2004 and 2005, and an increase in our ongoing online marketing efforts, particularly with the large portals (MSN, Yahoo & AOL), and keyword search (Google). In addition, we continued our television, print and radio campaigns through the first six months of 2005.

Technology expenses. Technology expenses increased 233%, from $1.8 million in the second quarter of 2004 to $6.1 million in second quarter of 2005. For the six months ended June 30, 2004 and 2005, technology costs increased 218%, from $3.2 million to $10.2 million respectively.

We have incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for the next growth period of our lifecycle. The increase in absolute dollars was primarily attributable to costs and depreciation associated with infrastructure, including expansion of corporate systems, such as Oracle licenses and development. The increase in technology expenses also included the costs associated with the strategic projects of 2005, namely, completion our auctions tab, reconstruction of our travel website, development of our search engine and the data warehouse and customer analytics system.

General and administrative expenses. General and administrative expenses increased 101% from $3.7 million in the second quarter of 2004 to $7.5 million during the second quarter of 2005, representing 4% and 5% of total revenue, respectively.

General and administrative expenses increased 72% from $8.6 million in the six-month period ended June 30, 2004 to $14.9 million in the same period ended June 30, 2005, representing 5% of total revenue for both periods.

The increase in general and administrative expenses relates to the increase in staffing, primarily in merchandising and finance. We also expect an additional increase of approximately $1 million quarterly for increased rent as a result of the relocation of the corporate office in July 2005.

Amortization of stock-based compensation. Prior to the Company s initial public offering in May 2002, the Company recorded unearned stock-based compensation related to stock options granted below the fair market value of the underlying stock. Since the initial public offering, the Company has not granted any additional stock options below fair market value. Amortization of stock-based compensation was approximately $123,000 and $53,000 for the three months ended June 30, 2004 and 2005, respectively and $258,000 and $73,000 for the six-month periods ended June 30, 2004 and 2005, respectively.

Non-operating income (expense)

Interest income, interest expense and other income (expense). The increase in interest income from $127,000 during the second quarter of 2004 to $896,000 during the second quarter of 2005 is due to the increase in our invested cash and marketable securities from our equity and debt offerings during 2004. For the six months ended June 30, 2004 and 2005, interest income totaled $225,000 and $1.5 million, respectively. Interest income was also offset by a loss due to changes in the fair value of our foreign corporate securities (Note 4).

Interest expense increased from $46,000 during the second quarter of 2004 to $1.5 million during the second quarter of 2005, primarily as a result of the interest expense from our convertible senior notes issued in November 2004. For the six months ended June 30, 2004 and 2005, interest expense totaled $62,000 and $3.0 million, respectively.

We recorded other income of $4.2 million during the second quarter of 2005 related the retirement of $33.0 million of the 3.75% Convertible Senior Notes (Note 12). No other income (expense) was recognized in the second quarter of 2004. For the six months ended June 30, 2004 other income totaled $2,000 and for the same period ended June 30, 2005 other income totaled $4.2 million.

Income taxes

Income taxes. For the three and six months ended June 30, 2004 and 2005, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2004 and June 30, 2005, we had $73.1 million and $82.5 million, respectively, of net operating loss carryforwards, of which $21.9 million is subject to limitation. These net operating loss carryforwards will begin to expire in 2019.

Recent Accounting Pronouncements

In March 2005, the Financial Accounting Standards Board (FASB) issued FIN 47 which clarifies guidance provided by Statement No. 143, Accounting for Asset Retirement Obligations. FIN 47 is effective for the Company no later than March 31, 2006. The adoption of FIN 47 is not expected to have a significant impact on the Company s financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004) *Share-Based Payment* (Statement FAS 123R). This standard requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. The effective date is the first annual reporting period beginning after June 15, 2005. The Company is currently evaluating pricing models and the transition provisions of this standard and will begin expensing all stock-based compensation in the first quarter of 2006.

On March 29, 2005, the SEC published Staff Accounting Bulletin (SAB) No. 107, which provides the Staffs views on a variety of matters relating to the interaction between Statement 123R and certain Securities and Exchange Commission Rules and regulations. The Company is currently evaluating the provisions of the SAB and will implement it when the Company begins expensing stock options under Statement 123R in the first quarter of 2006.

In March 2004, the FASB issued EITF Issue No. 03-1 (EITF 03-1), *The Meaning of Other-than-Temporary Impairments and its Application to Certain Investments,* which provides new guidance for assessing impairment losses on investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however, the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company will evaluate the impact of EITF 03-1 once final guidance is issued.

On June 7, 2005, the FASB issued Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements (FAS 154). FAS 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. FAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. FAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of FAS 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

Seasonality

Financial results for Internet retailers are generally seasonal. Based upon the Company s historical experience, increased revenues typically occur during the fourth quarter because of the Christmas retail season. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect the Company s results of operations in the future. The following table reflects the Company s revenues for each of the quarters available since 2002 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005	$ 165,881	$ 150,638		
2004	82,078	87,792	$ 103,444	$ 221,321
2003	29,164	28,833	57,788*	123,160
2002	12,067	14,380	23,808	41,529

* Note that beginning in the third quarter of 2003, total revenue reflects the change in the Company s returns policy, as a result of which sales by fulfillment partners are now recorded gross instead of net as in prior quarters.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Liquidity and Capital Resources

Prior to the second quarter of 2002, we financed our activities primarily through a series of private sales of equity securities, warrants to purchase our common stock and promissory notes. During the second quarter of 2002, we completed our initial public offering pursuant to which we received approximately $26.1 million in cash, net of underwriting discounts, commissions, and other related expenses. Additionally, we completed follow-on offerings in February 2003, May 2004 and November 2004, pursuant to which we received approximately $24.0 million, $37.9 million and $75.2 million, respectively, in cash, net of underwriting discounts, commissions, and other related expenses. In November 2004, we also received $116.2 million in proceeds from the issuance of our convertible senior notes. At June 30, 2005, our cash and cash equivalents balance was $31.4 million and our marketable securities totaled $88.6 million.

Our operating activities resulted in cash inflows of $10.4 million for the quarter ended June 30, 2004 and cash outflows of $10.1 million for the same quarter of 2005. For the six months ended June 30, 2004 and 2005, operating activities resulted in cash outflows of $11.4 million and $45.1 million, respectively. The primary operating uses of cash and cash equivalents during the first six months of 2005 was to fund our operations, including net losses of $6.2 million, increases in inventory of $15.0 million, prepaid expenses of $4.6 million and decrease in accounts payable of $24.6 million. This was offset by the change in prepaid inventory of $1.9 million and increase in accrued liabilities of $2.5 million.

Cash used in investing activities for the six months ending June 30, 2005 included $24.3 million in capital expenditures for property and equipment and a net increase of $2.0 million from the purchase and sales of marketable securities. For the six months ended June 30, 2004 and 2005, net cash used in investing activities amounted to $13.2 million and $23.3 million, respectively.

Net cash used in financing activities during the six months ended June 30, 2005 amounted to $98.7 million, consisting primarily of purchased call options totaling $47.5 million, payments on capital lease obligations of $3.1 million, payments on early extinguishment of debt of $27.9 million and purchase of treasury stock of $24.1 million. During that same period, we received proceeds from the exercise of stock options and warrants of $3.9 million. Net cash provided by financing activities during the quarter ended June 30, 2004 was $41.5 million, primarily from the issuance of common stock.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of June 30, 2005 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):

	Payments Due by Period				
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 years**
Long-term debt arrangements	$ 87,000	$	$	$	$ 87,000
Interest on convertible senior notes	21,469	1,894	6,525	6,525	6,525
Capital lease obligations	14,961	7,192	7,769		
Operating leases	73,803	4,939	13,435	15,304	40,125
Purchase obligations	81,400	81,400			
Total contractual cash obligations	$ 278,633	$ 95,425	$ 27,729	$ 21,829	$ 133,650

		Amounts of Commitment Expiration Per Period			
Other Commercial Commitments	**Total Amounts Committed**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**Over 5 years**
Letters of credit	$ 11,214	$ 11,214	$	$	$
Redeemable common stock	3,259		3,259		

Total commercial commitments	$	14,473	$	11,214	$	3,259