

OVERSTOCK.COM, INC
Form 10-Q
July 26, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

Or

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

For the transition period from _____ to _____

Commission file number: 000-49799

OVERSTOCK.COM, INC.

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(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

87-0634302
(I.R.S. Employer
Identification Number)

6350 South 3000 East

Salt Lake City, Utah 84121

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

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

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	June 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 59,998	\$ 96,985
Restricted cash	2,044	2,036
Accounts receivable, net	10,084	13,501
Inventories, net	21,074	22,993
Prepaid inventories, net	1,754	1,027
Prepays and other assets	15,097	12,651
Total current assets	110,051	149,193
Fixed assets, net	23,250	25,322
Goodwill	2,784	2,784
Other long-term assets, net	1,648	2,260
Total assets	\$ 137,733	\$ 179,559
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 40,625	\$ 70,332
Accrued liabilities	35,809	47,902
Deferred revenue	24,263	27,978
Line of credit	17,000	17,000
Capital lease obligations, current		110
Total current liabilities	117,697	163,322
Capital lease obligations, non-current		2
Other long-term liabilities	2,431	2,998
Total liabilities	120,128	166,322
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock, \$0.0001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none		
Common stock, \$0.0001 par value		
Authorized shares - 100,000		
Issued shares - 26,477 and 26,241		
Outstanding shares - 23,447 and 23,279	2	2
Additional paid-in capital	355,011	353,368
Accumulated deficit	(258,576)	(261,765)
Treasury stock:		
Shares at cost - 3,030 and 2,962	(78,832)	(78,368)

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Total stockholders' equity		17,605		13,237
Total liabilities and stockholders' equity	\$	137,733	\$	179,559

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Operations and Comprehensive Income (Loss)

(Unaudited)

(in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Revenue, net				
Direct	\$ 33,936	\$ 33,443	\$ 74,833	\$ 81,604
Fulfillment partner	205,600	201,549	427,070	418,858
Total net revenue	239,536	234,992	501,903	500,462
Cost of goods sold				
Direct(1)	31,108	30,231	68,738	73,261
Fulfillment partner	165,259	164,991	342,488	337,347
Total cost of goods sold	196,367	195,222	411,226	410,608
Gross profit	43,169	39,770	90,677	89,854
Operating expenses:				
Sales and marketing(1)	13,512	13,655	27,987	29,080
Technology(1)	15,122	16,808	30,760	33,468
General and administrative(1)	14,516	16,725	29,338	34,711
Restructuring			98	
Total operating expenses	43,150	47,188	88,183	97,259
Operating income (loss)	19	(7,418)	2,494	(7,405)
Interest income	27	46	56	98
Interest expense	(253)	(630)	(461)	(1,306)
Other income, net	719	220	1,151	409
Income (loss) before income taxes	512	(7,782)	3,240	(8,204)
Provision for income taxes	42	16	51	38
Net income (loss)	\$ 470	\$ (7,798)	\$ 3,189	\$ (8,242)
Deemed dividend related to redeemable common stock		(2)		(12)
Net income (loss) attributable to common shares	\$ 470	\$ (7,800)	\$ 3,189	\$ (8,254)
Net income (loss) per common share basic:				
Net income (loss) attributable to common shares basic	\$ 0.02	\$ (0.34)	\$ 0.14	\$ (0.36)
Weighted average common shares outstanding basic	23,437	23,265	23,382	23,240
Net income (loss) per common share diluted:				
Net income (loss) attributable to common shares diluted	\$ 0.02	\$ (0.34)	\$ 0.14	\$ (0.36)
Weighted average common shares outstanding diluted	23,464	23,265	23,399	23,240
Comprehensive income (loss)	\$ 470	\$ (7,798)	\$ 3,189	\$ (8,242)

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

Cost of goods sold direct	\$ 66	\$ 45	\$ 126	\$ 87
Sales and marketing	51	103	152	209
Technology	191	173	367	362
General and administrative	522	511	998	1,050

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Total	\$	830	\$	832	\$	1,643	\$	1,708
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See accompanying notes to consolidated financial statements.

Table of Contents**Overstock.com, Inc.****Consolidated Statements of Changes in Stockholders Equity****(Unaudited)****(in thousands)**

	Common stock			Additional Paid-in Capital	Accumulated Deficit	Treasury stock		Total
	Shares	Amount				Shares	Amount	
Balances at December 31, 2011	26,241	\$ 2	\$	353,368	\$ (261,765)	2,962	\$ (78,368)	\$ 13,237
Net income					3,189			3,189
Stock-based compensation to employees and directors				1,643				1,643
Common stock issued upon vesting of restricted stock	236							
Purchase of treasury stock						68	(464)	(464)
Balance at June 30, 2012	26,477	\$ 2	\$	355,011	\$ (258,576)	3,030	\$ (78,832)	\$ 17,605

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Six months ended June 30,		Twelve months ended June 30,	
	2012	2011	2012	2011
Cash flows from operating activities:				
Net income (loss)	\$ 3,189	\$ (8,242)	\$ (8,007)	\$ 3,259
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	8,096	8,263	16,183	16,197
Realized gain from sale of marketable securities	(7)		(7)	
Loss on disposition of fixed asset	61		61	
Stock-based compensation to employees and directors	1,643	1,708	2,986	4,279
Amortization of deferred loan costs and debt discount	37	60	104	242
(Gain) loss from early extinguishment of debt		27	1,226	(115)
Restructuring charges (reversals)	98		98	(433)
Changes in operating assets and liabilities:				
Restricted cash	(8)	147	351	533
Accounts receivable, net	3,417	6,918	(3,442)	1,643
Inventories, net	1,919	11,044	(4)	4,656
Prepaid inventories, net	(727)	405	(77)	1,041
Prepays and other assets	(2,890)	(4,321)	975	(3,160)
Other long-term assets, net	889	230	499	1,292
Accounts payable	(29,651)	(28,513)	1,806	(1,477)
Accrued liabilities	(12,352)	(8,773)	3,373	3,643
Deferred revenue	(3,715)	(2,573)	2,809	1,268
Other long-term liabilities	60	84	324	(144)
Net cash provided by (used in) operating activities	(29,941)	(23,536)	19,258	32,724
Cash flows from investing activities:				
Purchases of marketable securities	(55)	(79)	(136)	(152)
Sale of marketable securities	154		154	
Proceeds from sale of fixed assets	55		55	
Purchases of intangible assets	(6)		(10)	(396)
Investment in precious metals				(1,567)
Expenditures for fixed assets, including internal-use software and website development	(6,503)	(4,024)	(11,220)	(9,708)
Net cash used in investing activities	(6,355)	(4,103)	(11,157)	(11,823)
Cash flows from financing activities:				
Payments on capital lease obligations	(112)	(568)	(274)	(701)
Drawdowns on line of credit			17,000	
Capitalized financing costs			(140)	
Proceeds from finance obligations		748	681	17,131
Payments on finance obligations		(2,066)	(22,852)	(2,907)
Paydown on direct financing arrangement	(115)	(106)	(225)	(207)
Payments to retire convertible senior notes		(10,110)	(24,505)	(25,927)
Purchase of redeemable stock				(26)
Purchase of treasury stock	(464)	(1,600)	(468)	(1,607)
Exercise of stock options				15

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Net cash used in financing activities	(691)	(13,702)	(30,783)	(14,229)
Net increase (decrease) in cash and cash equivalents	(36,987)	(41,341)	(22,682)	6,672
Cash and cash equivalents, beginning of period	96,985	124,021	82,680	76,008
Cash and cash equivalents, end of period	\$ 59,998	\$ 82,680	\$ 59,998	\$ 82,680

Supplemental disclosures of cash flow

information:

Cash paid during the period:

Interest paid	\$ 294	\$ 1,191	\$ 1,472	\$ 2,383
Taxes paid	4	260	4	260

Non-cash investing and financing activities:

Change in fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	\$ 279	\$ 354	\$ (666)	\$ 3
Equipment acquired under finance obligations		3,686	1,391	4,285
Equipment and software acquired under capital lease obligations				6
Lapse of rescission rights of redeemable stock		473	109	733

See accompanying notes to consolidated financial statements.

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Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

As used herein, Overstock.com, we, our and similar terms include Overstock.com, Inc. and its subsidiaries, unless the context indicates otherwise. The accompanying unaudited consolidated financial statements have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2011. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

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

Use of estimates

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

Cash equivalents

We classify all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were \$33.1 million and \$81.2 million at June 30, 2012 and December 31, 2011, respectively.

Restricted cash

We consider cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash. Restricted cash was \$2.0 million and \$2.0 million at June 30, 2012 and December 31, 2011, respectively, and was held primarily in money market accounts.

Fair value of financial instruments

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

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

- Level 1 Quoted prices for identical instruments in active markets;
- Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are

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observable in active markets; and

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

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

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

	Fair Value Measurements at June 30, 2012:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents and restricted cash - Money market mutual funds	\$ 35,143	\$ 35,143	\$	\$
Trading securities held in a rabbi trust (1)	222	222		
Total assets	\$ 35,365	\$ 35,365	\$	\$
Liabilities:				
Deferred compensation accrual rabbi trust (2)	215	215		
Total liabilities	\$ 215	\$ 215	\$	\$

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

	Fair Value Measurements at December 31, 2011:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents and restricted cash - Money market mutual funds	\$ 83,195	\$ 83,195	\$	\$
Trading securities held in a rabbi trust (1)	302	302		
Total assets	\$ 83,497	\$ 83,497	\$	\$
Liabilities:				
Deferred compensation accrual rabbi trust (2)	302	302		
Total liabilities	\$ 302	\$ 302	\$	\$

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

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

Restricted investments

In December 2009, we implemented a Non Qualified Deferred Compensation Plan (the "NQDC Plan") for senior management. Deferred compensation amounts are invested in mutual funds held in a rabbi trust and are restricted for payment to the participants of the NQDC Plan. We account for our investments held in the trust in accordance with Accounting Standards Codification (ASC) No. 320 *Investments Debt and Equity Securities*. The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled \$222,000 at June 30, 2012 and are included in Other current and long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three and six months ended June 30, 2012 and 2011.

Accounts receivable

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

Allowance for doubtful accounts

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our business customers' financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was \$625,000 and \$574,000 at June 30, 2012 and December 31, 2011, respectively.

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Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At June 30, 2012 and December 31, 2011, two banks held the majority of our cash and cash equivalents. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

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

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

Valuation of inventories

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

Prepaid inventories, net

Prepaid inventories represent inventories paid for in advance of receipt. Prepaid inventories were \$1.8 million and \$1.0 million at June 30, 2012 and December 31, 2011, respectively.

Prepays and other assets

Prepays and other assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs, as well as investments in precious metals. Total prepaids and other assets were \$15.1 million and \$12.7 million at June 30, 2012 and December 31, 2011, respectively.

Fixed assets

Fixed assets, which include assets such as technology infrastructure, internal-use software, website development, furniture and fixtures and leasehold improvements, are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets or the term of the related capital lease, whichever is shorter, as follows:

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

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

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Cost of goods sold - direct	\$ 120	\$ 218	\$ 228	\$ 446
Technology	3,600	3,761	7,199	7,243
General and administrative	342	285	669	574
Total depreciation and amortization, including internal-use software and website development	\$ 4,062	\$ 4,264	\$ 8,096	\$ 8,263

Internal-use software and website development

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

During the three months ended June 30, 2012 and 2011, we capitalized \$2.4 million and \$3.7 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was \$2.2 million and \$2.1 million for those respective periods. During the six months ended June 30, 2012 and 2011, we capitalized \$3.9 million and \$5.6 million, respectively, of such costs and had amortization of \$4.3 million and \$4.0 million for those respective periods.

Revenue recognition

We derive our revenue primarily from two sources: direct revenue and fulfillment partner revenue, including listing fees and commissions collected from products being listed and sold through our cars listing business, and from advertising on our shopping, travel and insurance pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and fulfillment partner revenue (see Note 8 Business Segments).

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

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

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

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

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

Direct revenue

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

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Fulfillment partner revenue

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

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

Club O loyalty program

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

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

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

Co-branded credit card program

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

Deferred revenue

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

Sales returns allowance

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

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

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

Revenue is recorded net of estimated returns. We record an allowance for returns based on current period revenues and historical returns experience. We analyze actual historical returns, current economic trends and changes in order volume and acceptance of our products when evaluating the adequacy of the sales returns allowance in any accounting period.

The allowance for returns was \$5.7 million and \$10.9 million at June 30, 2012 and December 31, 2011 respectively. The decrease in allowance for returns at June 30, 2012 compared to December 31, 2011 is primarily due to decreased revenues mostly due to seasonality.

Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was \$134,000 and \$187,000 at June 30, 2012 and December 31, 2011, respectively.

Cost of goods sold

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

Total revenue, net	\$	239,536	100%	\$	234,992	100%	\$	501,903	100%	\$	500,462	100%
Cost of goods sold												
Product costs and other cost of goods sold		184,121	77%		182,869	78%		385,914	77%		384,129	77%
Fulfillment and related costs		12,246	5%		12,353	5%		25,312	5%		26,479	5%
Total cost of goods sold		196,367	82%		195,222	83%		411,226	82%		410,608	82%
Gross profit	\$	43,169	18%	\$	39,770	17%	\$	90,677	18%	\$	89,854	18%

Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled \$11.6 million and \$11.3 million during the three months ended June 30, 2012 and 2011, respectively. For the six months ended June 30, 2012 and 2011, advertising expenses totaled \$24.1 million and \$24.2 million, respectively. Prepaid advertising, which consists primarily of prepaid advertising airtime, (included in Prepaids and other assets in the accompanying consolidated balance sheets) was \$1.1 million and \$1.4 million at June 30, 2012 and December 31, 2011, respectively.

Stock-based compensation

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

Loss contingencies

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

Table of Contents*Restructuring*

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

Income taxes

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

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

Earnings (loss) per share

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

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net income (loss)	\$ 470	\$ (7,798)	\$ 3,189	\$ (8,242)

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Deemed dividend related to redeemable common stock			(2)		(12)
Net income (loss) attributable to common shares	\$	470	\$	(7,800)	\$ 3,189 \$ (8,254)
Net income (loss) per common share basic:					
Net income (loss) attributable to common shares basic	\$	0.02	\$	(0.34)	\$ 0.14 \$ (0.36)
Weighted average common shares outstanding basic		23,437		23,265	23,382 23,240
Effect of dilutive securities:					
Stock options and restricted stock awards		27			17
Weighted average common shares outstanding diluted		23,464		23,265	23,399 23,240
Net income (loss) attributable to common shares diluted	\$	0.02	\$	(0.34)	\$ 0.14 \$ (0.36)

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Stock options and restricted stock awards	709	1,020	892	1,020
Convertible senior notes		321		321

Table of Contents**3. RESTRUCTURING EXPENSE**

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

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

	Balance at 12/31/2011		Accretion Expense		Net Cash Payments		Adjustments		Balance at 6/30/2012
Lease and contract termination costs	\$ 1,491	\$	76	\$	(235)	\$	98	\$	1,430

We incurred no lease termination costs during the three months ended June 30, 2012, and \$98,000 of lease termination costs during the six months ended June 30, 2012 due to changes in the estimate of sublease income as a result of our entering into a revised agreement with a sublessee and ceasing the use of some of our office facilities. There were no restructuring charges or reversals during the three and six months ended June 30, 2011.

4. BORROWINGS*U.S. Bank Financing Agreements*

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

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

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

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

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

Amounts outstanding under the Financing Agreement were \$17.0 million at June 30, 2012 and December 31, 2011, and letters of credit totaling \$2.0 million and \$2.0 million, respectively, were issued on our behalf collateralized by compensating cash balances

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held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets. At June 30, 2012, we had \$20.0 million in compensating cash balances held at U.S. Bank. If we draw on the \$20.0 million compensating cash balance, it will constitute a triggering event and result in additional and more restrictive covenants.

U.S. Bank Commercial Purchasing Card Agreement

We have a commercial purchasing card (the Purchasing Card) agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At June 30, 2012, \$2.9 million was outstanding and \$2.1 million was available under the Purchasing Card. At December 31, 2011, \$3.4 million was outstanding and \$1.6 million was available under the Purchasing Card.

5. COMMITMENTS AND CONTINGENCIES

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of June 30, 2012, are as follows (in thousands):

Payments due by period	
2012 (remainder)	\$ 4,277
2013	8,206
2014	8,404
2015	6,814
2016	1,381
Thereafter	183
	\$ 29,265

Rental expense for operating leases totaled \$2.2 million and \$2.0 million for the three months ended June 30, 2012 and 2011, respectively and \$4.4 million and \$4.0 million for the six months ended June 30, 2012 and 2011, respectively. Estimated sublease income of \$793,000 is expected over the next three years of which \$260,000 is anticipated to be received in the next 12 months.

Legal Proceedings

From time to time, we are involved in litigation concerning consumer protection, employment, intellectual property and other commercial matters related to the conduct and operation of our business and the sale of products on our Website. In connection with such litigation, we may be subject to significant damages. In some instances other parties may have contractual indemnification obligations to us. However, such contractual obligations may prove unenforceable or non-collectible, and in the event we cannot enforce or collect on indemnification obligations, we may bear the full responsibility for damages, fees and costs resulting from such litigation. We may also be subject to equitable remedies and

penalties. Such litigation could be costly and time consuming and could divert or distract our management and key personnel from our business operations. Due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows.

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

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the action as to that defendant. On August 19, 2011, the remaining defendants filed a motion for summary judgment. On January 10, 2012 the court granted the motion for summary judgment as to all remaining defendants and judgment has been entered. We have appealed. The defendants have applied to the court for reimbursement from us of their allowable court costs in the collective amount of \$2.4 million. We believe the full amount applied for is excessive and not permissible under California law. In the trial court we have contested the requested costs amount. The court has not heard arguments on the disputed costs amount. The nature of the loss contingencies relating to any court costs ordered against us are described above.

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

On August 12, 2008, we along with seven other defendants, were sued in the United States District Court for the Northern District of California, by Sean Lane, and seventeen other individuals, on their own behalf and for others similarly in a class action suit, alleging violations of the Electronic Communications Privacy Act, Computer Fraud and Abuse Act, Video Privacy Protection Act, and California's Consumer Legal Remedies Act and Computer Crime Law. The complaint relates to our use of a product known as Facebook Beacon, created and provided to us by Facebook, Inc. Facebook Beacon provided the means for Facebook users to share purchasing data among their Facebook friends. The parties extended by agreement the time for defendants' answer, including our answer, and thereafter, the Plaintiff and Facebook proposed a stipulated settlement to the court for approval, which would resolve the case without requirement of financial contribution from us. On March 17, 2010, over objections lodged by some parties, the court accepted the proposed settlement. Various parties objecting to the settlement have appealed and their appeal is now pending. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made.

On November 14, 2008, we filed suit in Ohio state court against the Ohio Tax Commissioner, the Ohio Attorney General and the Governor of Ohio, alleging the Ohio Commercial Activity Tax is unconstitutional. Enacted in 2005, Ohio's Commercial Activity Tax is based on activities in Ohio that contribute to production or gross income for a company whether or not the company has a physical presence in or nexus within the state. Our complaint asked for a judgment declaring the tax unconstitutional and for an injunction preventing any enforcement of the tax. The defendants moved to dismiss the case. On July 28, 2009, the trial court ruled that there was no justiciable controversy in the case, as we had not yet been assessed a tax, and it granted the defendants' motions to dismiss. In September 2009, we received a letter of determination from the Ohio Department of Taxation noting the Department's determination that we are required to register for remitting of the Commercial Activity Tax, and owe \$612,784 in taxes, interest, and penalties as of June 30, 2009. The Ohio Department of Taxation issued additional estimated assessments of estimated tax, interest and penalties totaling \$121,958 as of December 31, 2011. We have filed protests to challenge the Department's Assessments on constitutional grounds and the matter is currently pending before the Ohio Department of Taxation's Legal Division for administrative review and determination. A hearing on these matters was held November 18, 2011. No administrative ruling has been issued following the hearing. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We believe the determinations to be unlawful and erroneous and are vigorously contesting the determination.

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

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loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action.

On September 23, 2009, SpeedTrack, Inc. sued us along with 27 other defendants in the United States District Court in the Northern District of California. We are alleged to have infringed a patent covering search and categorization software. We believe that certain third party vendors of products and services sold to us are contractually obligated to indemnify us in this action. On November 11, 2009, the parties stipulated to stay all proceedings in the case until resolution of a the United States Patent and Trademark Office had concluded and resolved a reexamination of the patent in question, and also until a previously filed infringement action against Wal-Mart Stores, Inc. and other retailers resulted either in judgment or dismissal. Subsequently, the parties agreed to extend the time for defendants' complaint answer until 21 days following a court order to lift the stay to which the parties stipulated. The United States Patent and Trademark Office resolved the reexamination of the patent in question in favor of SpeedTrack, Inc. The case remains stayed, pending the outcome of the infringement action against Wal-Mart Stores, Inc. and other retailers. On February 22, 2012, the court in the Wal-Mart Stores case granted Wal-Mart Stores' motion for summary judgment of non-infringement. The court also granted Speedtrack's motion for summary judgment on patent validity. It is not known whether the summary judgments granted in the Wal-Mart Stores case will have an effect on the Speedtrack case in which we are named as one of the defendants. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On or about September 25, 2009, Alcatel-Lucent USA, Inc. filed suit against us and 12 other defendants in the United States District Court in the Eastern District of Texas. We are alleged to have infringed three patents purportedly related to a communications protocol between a user and server terminals, text input functionalities and search processes. We believe a third party vendor of search products and services sold to us is contractually obligated to indemnify us in this action as it pertains to the search patent. On October 14, 2011, a jury returned a verdict in our favor, finding non-infringement on all asserted claims, on all patents, and finding of invalidity of the Alcatel-Lucent patent, having to do with a communications protocol. On November 29, 2011, Alcatel-Lucent filed a motion for a new trial and for judgment as a matter of law. We have opposed the motion. The court has not ruled on the motion.

On May 11, 2010, Site Update Solutions, LLC filed suit against us and 34 other defendants in the United States District Court in the Eastern District of Texas (now transferred to the Northern District of California) for infringement of a patent claiming "a process for maintaining ongoing registration for pages on a given search engine . . . a method to actively cause an updating of a specific Internet search engine database regarding a particular WWW resource." We, along with other defendants, filed a motion to transfer venue. The court granted the motion, and the case is now transferred to the Northern District of California. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors, if any.

On September 29, 2010, a trustee in bankruptcy filed against us an adversary proceeding in the matter of In re: Petters Company, Inc., a case filed in United States Bankruptcy Court, in the District of Minnesota. The complaint alleges principal causes of action against us under various Bankruptcy Code sections and the Minnesota Fraudulent Transfer Act, to recover damages for alleged transfers of property from the Petters Company occurring prior to the filing of the case initially as a civil receivership in October 2008. The trustee's complaint alleges such transfers occurred in at least one note transaction whereby we transferred at least \$2.3 million and received in return transfers totaling at least \$2.5 million. The trustee does not specify a date for the transactions; however we believe that any alleged transaction with the Petters Company would have taken place in excess of seven years from the date of the filing of the adversary proceeding. The case is in its early stages. We filed a motion to dismiss on statute of limitations and other grounds. The court has not ruled upon the motion to dismiss. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action.

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On November 17, 2010 we were sued in the Superior Court of California, County of Alameda, by District Attorneys for the California Counties of Alameda, Marin, Monterey, Napa, Santa Clara, Shasta and Sonoma County, and the County of Santa Cruz recently joined the suit. These district attorneys seek damages and an injunction under claims for violations of California consumer protection laws, alleging we made untrue or misleading statements concerning our pricing, price reductions, sources of products and shipping charges. The complaint asks for damages in the amount of not less than \$15 million. The suit is in the discovery stage. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to vigorously defend this action.

On September 11, 2011, Droplets, Inc. filed suit against us and eight other defendants in the United States District Court in the Eastern District of Texas for infringement of a patent covering strings of programming code downloaded from a server to a client computer. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On September 13, 2011, Select Retrieval, LLC filed suit against us and 79 other defendants in the United States District Court for the District of Delaware for infringement of a patent covering the hierarchical display of interactive links on a webpage. We filed a

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motion to dismiss which was denied. We have not answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

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

On December 29, 2011 The Tobin Family Education and Health Foundation filed suit against us in the United States District Court for the District of New Jersey for infringement of a patent covering a method and system for customizing marketing services on networks communication with hypertext tagging conventions. We have tendered the defense of this action to an indemnitor which has accepted the defense. We filed a motion to dismiss and the plaintiff amended the complaint. Subsequently, we filed a motion to transfer the case to the United States District Court for the District of Utah. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On January 27, 2012, Pragmatus Telecom, LLC filed suit against us in the United States District Court for the District of Delaware for infringement of two patents covering a system for coordinating data and voice communications via customer contact channel changing system using voice over IP and infringement of one patent for coordinating data and voice communications via customer contact channel changing system. We have answered the complaint. We believe we are indemnified by other vendors, some of which have intervened and filed motions on our behalf. These indemnitors have not yet accepted full responsibility for defense of this action. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On March 1, 2012, H-W Technology, L.C. filed suit against us in the United States District Court in the Northern District of Texas for infringement of a patent entitled Internet Protocol (IP) Phone with Search and Advertising Capability. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors, if any.

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

On May 10, 2012, Lodsyst Group, LLC filed suit against us and seven other defendants in the United States District Court for the Eastern District of Texas for infringement of a patent covering method and system for gathering information from units of a commodity across a network. We have tendered the defense of this action to an indemnitor which has accepted the defense. We have not answered the complaint. The case is in its

early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On July 16, 2012, Digitech Image Technologies, LLC filed against us and forty-five other defendants in the United States District Court for the Central District of California for infringement of a patent covering camera imaging technology that facilitates prediction of color and location on a digital image within the camera. The patent is entitled "Device Profiles for use in a Digital Image Processing System." We believe we are indemnified by other vendors. We have not yet been served with the complaint and the case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On July 19, 2012, Data Carriers LLC filed against us in the United States District Court for the District of Delaware for infringement of a patent entitled, "Proactive presentation of automating features to a computer user." We have been served with the complaint, but have not answered. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

We establish liabilities when a particular contingency is probable and estimable. As of June 30, 2012, we have accrued \$2.9 million in light of these probable and estimable liabilities. It is reasonably possible that the actual losses may exceed our accrued liabilities. We have other contingencies which are reasonably possible; however, the reasonably possible exposure to losses cannot currently be estimated.

6. INDEMNIFICATIONS AND GUARANTEES

During our normal course of business, we have made certain indemnities, commitments, and guarantees under which we may

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

7. STOCK-BASED AWARDS

We have equity incentive plans that provide for the grant to employees of stock-based awards, including stock options and restricted stock.

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Stock options	\$ 1	\$ 32	\$ 3	\$ 181
Restricted stock awards	829	800	1,640	1,527
Total stock-based compensation expense	\$ 830	\$ 832	\$ 1,643	\$ 1,708

Restricted stock awards

During the three and six months ended June 30, 2012, the Compensation Committee of the Board of Directors approved grants of 105,000 and 793,000 restricted stock awards to our officers, board members and employees, for the respective periods. The restricted stock awards vest over three years at 25% at the end of the first year, 25% at the end of the second year and 50% at the end of the third year and are subject to the employee's continuing service to us. At June 30, 2012, there were 1,038,000 unvested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is recognized on a straight line basis over the three-year vesting schedule. The weighted average grant date fair value of restricted stock awards granted during the three and six months ended June 30, 2012 was \$6.51 and \$6.74, respectively.

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

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Six months ended
June 30, 2012

	Units	Weighted Average Grant Date Fair Value
Outstanding beginning of year	522	\$ 13.40
Granted at fair value	793	6.74
Vested	(236)	12.06
Forfeited	(41)	8.85
Outstanding end of period	1,038	\$ 8.80

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

	Three months ended June 30, Fulfillment partner			Six months ended June 30, Fulfillment partner		
	Direct		Total	Direct		Total
2012						
Revenue, net	\$ 33,936	\$ 205,600	\$ 239,536	\$ 74,833	\$ 427,070	\$ 501,903
Cost of goods sold	31,108	165,259	196,367	68,738	342,488	411,226
Gross profit	\$ 2,828	\$ 40,341	\$ 43,169	\$ 6,095	\$ 84,582	\$ 90,677
Operating expenses			(43,150)			(88,183)
Other income (expense), net			493			746
Provision for income taxes			42			51
Net income			\$ 470			\$ 3,189
2011						
Revenue, net	\$ 33,443	\$ 201,549	\$ 234,992	\$ 81,604	\$ 418,858	\$ 500,462
Cost of goods sold	30,231	164,991	195,222	73,261	337,347	410,608
Gross profit	\$ 3,212	\$ 36,558	\$ 39,770	\$ 8,343	\$ 81,511	\$ 89,854
Operating expenses			(47,188)			(97,259)
Other income (expense), net			(364)			(799)
Provision for income taxes			16			38
Net loss			\$ (7,798)			\$ (8,242)

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

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

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

For the three and six months ended June 30, 2012 and 2011, over 99% of sales were made to customers in the United States. At June 30, 2012 and December 31, 2011, all of our fixed assets were located in the United States.

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

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents incorporated herein by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are therefore entitled to the protection of the safe harbor provisions of these laws. These forward-looking statements involve risks and uncertainties, and relate to future events or our future financial or operating performance. The forward-looking statements include all statements other than statements of historical fact, including, without limitation, all statements regarding:

- *the anticipated benefits and risks of our business and plans;*
- *our ability to attract and retain customers in a cost-efficient manner;*
- *the effectiveness of our marketing;*
- *our future operating and financial results;*
- *the competition we face and will face in our business;*
- *the effects of government regulation;*
- *our future capital requirements and our ability to satisfy our capital needs;*
- *our expectations regarding the adequacy of our liquidity;*
- *our ability to retire or refinance our debt;*
- *our plans for international markets;*
- *our plans for changes to our business;*
- *our beliefs regarding current or future litigation or regulatory actions;*
- *our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business;*
- *our beliefs regarding the adequacy of our insurance coverage;*
- *the adequacy of our infrastructure, including our backup facilities and our disaster planning;*
- *our belief that we can meet our published product shipping standards even during periods of relatively high sales activity;*
- *our belief that we can maintain or improve upon customer service levels that we and our customers consider acceptable;*
- *our beliefs regarding the adequacy of our order processing systems and our fulfillment and distribution capabilities;*

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- *our beliefs regarding the adequacy of our customer service capabilities;*
- *our beliefs and expectations regarding the adequacy of our office and warehouse facilities;*
- *our expectations regarding our travel shopping service, our insurance shopping service, our international sales efforts, our car listing service and our community site, and the anticipated functionality and results of operations of any of them;*
- *our belief that we and our fulfillment partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business;*
- *our belief that our sales through other ecommerce marketplace channels will be successful and become an important part of our business;*
and
- *our belief that we can successfully offer and sell a constantly changing mix of products and services.*

Furthermore, in some cases, you can identify forward-looking statements by terminology such as may, will, could, should, expect, plan, intend, anticipate, believe, estimate, predict, potential or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider the risks outlined in our Annual Report on Form 10-K for the year ended December 31, 2011, including those described in Item 1A under the caption

Risk Factors. These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Except as otherwise required by law, we expressly disclaim any obligation to release publicly any update or revisions to any forward-looking statements to reflect any changes in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

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

Available Information

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

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Overview

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

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

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

Executive Commentary

This executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business. This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire

Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as our interim and audited financial statements, and the discussion of our business and risk factors and other information included elsewhere or incorporated in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements at the beginning of Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

We had net income of \$470,000 in Q2 2012 versus a net loss of \$7.8 million in Q2 2011. In Q2 2012, Contribution (see Non-GAAP Financial Measures below for a reconciliation of Contribution to Gross Profit) improved by \$3.5 million and Technology and General and Administrative expenses declined by \$3.9 million compared to Q2 2011. Our efforts to appropriately size the company's expense structure that we began in Q4 2011 have provided benefits as compensation costs included in operating expenses decreased by \$2.8 million in Q2 2012, compared to Q2 2011. In addition, legal costs decreased \$1.6 million in Q2 2012, compared to Q2 2011.

Our revenues in Q2 2012 increased by two percent compared to Q2 2011 due, in part, to increases in unique visitors and average order size, partially offset by lower conversion rates. We had fewer orders in Q2 2012 compared to Q2 2011. Unique visits in Q2 2012 increased by twelve percent and new customer growth increased three percent compared to Q2 2011.

In January of this year, we eliminated a number of current and open positions from our corporate staff and at June 30, 2012, our headcount was approximately 170 corporate employees less than at June 30, 2011. This decrease in headcount resulted in a savings of compensation related expenses of \$2.8 million in Q2 2012 compared to Q2 2011.

Our fulfillment partner business continues to make up a large percentage of our total revenues. Nearly eighty six percent of our revenues were fulfilled by our fulfillment partners in Q2 2012. As a result, we are able to operate the business with less inventory and we are converting revenues into cash on average nearly eight days before we pay our suppliers. This has reduced the demands on our own capital to operate the business. This dynamic helped us to generate positive operating cash flows on a trailing twelve month basis for every quarter for the past several years. Our working capital improved from \$(14.1) million at December 31, 2011 to \$(7.6) million at June 30, 2012.

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

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(as a percentage of total net revenue)			
Revenue, net				
Direct	14.2%	14.2%	14.9%	16.3%
Fulfillment partner	85.8	85.8	85.1	83.7
Total net revenue	100.0	100.0	100.0	100.0
Cost of goods sold				
Direct	13.0	12.9	13.7	14.6
Fulfillment partner	69.0	70.2	68.2	67.4
Total cost of goods sold	82.0	83.1	81.9	82.0
Gross profit	18.0	16.9	18.1	18.0
Operating expenses:				
Sales and marketing	5.6	5.8	5.6	5.8
Technology	6.3	7.2	6.1	6.7
General and administrative	6.1	7.1	5.8	6.9
Restructuring				
Total operating expenses	18.0	20.1	17.6	19.4
Operating income		(3.2)	0.5	(1.4)
Interest income				
Interest expense	(0.1)	(0.3)	(0.1)	(0.3)
Other income, net	0.3	0.1	0.2	0.1
Net income (loss) before income taxes	0.2	(3.4)	0.6	(1.6)
Provision for income taxes				
Net income (loss)	0.2%	(3.4)%	0.6%	(1.6)%

Comparisons of Three Months Ended June 30, 2012 to Three Months Ended June 30, 2011, and Six Months Ended June 30, 2012 to Six Months Ended June 30, 2011.

Revenue

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

	Three months ended June 30,				Six months ended June 30,			
	2012	2011	\$ Change	% Change	2012	2011	\$ Change	% Change
Revenue, net								
Direct	\$ 33,936	\$ 33,443	\$ 493	1.5%	\$ 74,833	\$ 81,604	\$ (6,771)	(8.3)%

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Fulfillment partner	205,600	201,549	4,051	2.0%	427,070	418,858	8,212	2.0%
Total revenue, net	\$ 239,536	\$ 234,992	\$ 4,544	1.9%	\$ 501,903	\$ 500,462	\$ 1,441	0.3%

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

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

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

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

Total revenues from International sales were \$2.0 million and \$1.7 million for the three months ended June 30, 2012 and 2011, respectively and \$4.3 million and \$4.0 million for the six months ended June 30, 2012 and 2011, respectively.

Change in estimate of average transit times (days)

Revenue related to merchandise sales is recognized upon delivery to our customers. As we ship high volumes of packages through multiple carriers, it is not practical for us to track the actual delivery date of each shipment. Therefore, we use estimates to determine which shipments are delivered and, therefore, recognized as revenue at the end of the period. Our delivery date estimates are based on average shipping transit times. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

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

Change in the Estimate of Average Transit Times (Days)	Three months ended June 30, 2012	
	Increase (Decrease) Revenue	Increase (Decrease) Net Income
2	\$ (9,559)	\$ (1,629)
1	\$ (4,054)	\$ (672)
As reported	As reported	As reported
-1	\$ 2,798	\$ 478
-2	\$ 5,310	\$ 910

See Executive Commentary above for additional discussion regarding revenue.

Gross profit and gross margin

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

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

	Three months ended June 30,				Six months ended June 30,			
	2012	2011	\$ Change	% Change	2012	2011	\$ Change	% Change
Revenue, net								
Direct	\$ 33,936	\$ 33,443	\$ 493	1.5%	\$ 74,833	\$ 81,604	\$ (6,771)	(8.3)%
Fulfillment partner	205,600	201,549	4,051	2.0%	427,070	418,858	8,212	2.0%
Total net revenues	\$ 239,536	\$ 234,992	\$ 4,544	1.9%	\$ 501,903	\$ 500,462	\$ 1,441	0.3%
Cost of goods sold								
Direct	\$ 31,108	\$ 30,231	\$ 877	2.9%	\$ 68,738	\$ 73,261	\$ (4,523)	(6.2)%
Fulfillment partner	165,259	164,991	268	0.2%	342,488	337,347	5,141	1.5%
Total cost of goods sold	\$ 196,367	\$ 195,222	\$ 1,145	0.6%	\$ 411,226	\$ 410,608	\$ 618	0.2%
Gross Profit								
Direct	\$ 2,828	\$ 3,212	\$ (384)	(12.0)%	\$ 6,095	\$ 8,343	\$ (2,248)	(26.9)%
Fulfillment partner	40,341	36,558	3,783	10.3%	84,582	81,511	3,071	3.8%
Total gross profit	\$ 43,169	\$ 39,770	\$ 3,399	8.5%	\$ 90,677	\$ 89,854	\$ 823	0.9%

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

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

The 130 and 210 basis point decreases in direct gross margin for the three and six months ended June 30, 2012 when compared to the same periods in 2011 are primarily due to higher freight and warehouse costs as a percentage of revenue and higher return-related costs, partially offset by pricing initiatives and lower credit card costs.

The 150 and 30 basis point increases in fulfillment partner gross margin for the three and six months ended June 30, 2012 when compared to the same periods in 2011 are primarily due to pricing initiatives and lower credit card costs, partially offset by higher return-related and freight costs.

The other factors described above, such as coupons, promotions and operational costs did not have a significant impact on the change in gross profit.

Cost of goods sold includes stock-based compensation expense of \$66,000 and \$45,000 for the three months ended June 30, 2012 and 2011, respectively and \$126,000 and \$87,000 for the six months ended June 30, 2012 and 2011, respectively.

See Executive Commentary above for additional discussion.

Operating expenses*Sales and marketing expenses*

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

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

Three months ended June 30,				Six months ended June 30,			
2012	2011	\$ Change	% Change	2012	2011	\$ Change	% Change

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Sales and marketing expenses	\$ 13,512	\$ 13,655	\$ (143)	(1.0)%	\$ 27,987	\$ 29,080	\$ (1,093)	(3.8)%
Sales and marketing expenses as a percent of net revenues	5.6%	5.8%			5.6%	5.8%		

Sales and marketing expenses as a percentage of revenue decreased by 20 basis points for the three months ended June 30, 2012. This is primarily due to lower compensation-related costs primarily due to lower headcount, partially offset by higher spending on advertising. Sales and marketing expenses as a percentage of revenue decreased by 20 basis points for the six months ended June 30, 2012. This is primarily due to lower compensation-related costs primarily due to lower headcount.

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

Sales and marketing expenses include stock-based compensation expense of \$51,000 and \$103,000 for the three months ended June 30, 2012 and 2011, respectively and \$152,000 and \$209,000 for the six months ended June 30, 2012 and 2011, respectively.

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

Technology expenses

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

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	Three months ended June 30,				Six months ended June 30,			
	2012	2011	\$ Change	% Change	2012	2011	\$ Change	% Change
Technology expenses	\$ 15,122	\$ 16,808	\$ (1,686)	(10.0)%	\$ 30,760	\$ 33,468	\$ (2,708)	(8.1)%
Technology expenses as a percent of net revenues	6.3%	7.2%			6.1%	6.7%		

The \$1.7 million and \$2.7 million decreases for the three and six months ended June 30, 2012, respectively, are primarily due to decreases in compensation and recruiting related costs primarily from lower headcount.

Technology expenses include stock-based compensation expense of \$191,000 and \$173,000 for the three months ended June 30, 2012 and 2011, respectively and \$367,000 and \$362,000 for the six months ended June 30, 2012 and 2011, respectively.

General and administrative expenses

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

	Three months ended June 30,				Six months ended June 30,			
	2012	2011	\$ Change	% Change	2012	2011	\$ Change	% Change
General and administrative expenses	\$ 14,516	\$ 16,725	\$ (2,209)	(13.2)%	\$ 29,338	\$ 34,711	\$ (5,373)	(15.5)%
General and administrative expenses as a percent of net revenues	6.1%	7.1%			5.8%	6.9%		

The \$2.2 million and \$5.4 million decreases in general and administrative expenses (G&A) for the three and six months ended June 30, 2012, respectively, are primarily due to decreases in legal fees and compensation-related costs primarily due to lower headcount.

G&A expenses include stock-based compensation expense of approximately \$522,000 and \$511,000 for the three months ended June 30, 2012 and 2011, respectively, and \$1.0 million and \$1.1 million for the six months ended June 30, 2012 and 2011, respectively.

Restructuring

We incurred zero and \$98,000 of lease termination costs during the three and six months ended June 30, 2012, respectively, due to changes in the estimate of sublease income as a result of our entering into a revised agreement with a sublessee and ceasing the use of some of our office facilities. There were no restructuring charges or reversals during the three and six months ended June 30, 2011.

Depreciation expense

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

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Cost of goods sold - direct	\$ 120	\$ 218	\$ 228	\$ 446
Technology	3,600	3,761	7,199	7,243
General and administrative	342	285	669	574
Total depreciation and amortization, including internal-use software and website development	\$ 4,062	\$ 4,264	\$ 8,096	\$ 8,263

Non-operating income (expense)*Interest income*

Interest income is primarily derived from the investment of our cash in cash equivalents and short-term investments. Interest income for the three months ended June 30, 2012 and 2011 totaled \$27,000 and \$46,000, respectively and \$56,000 and \$98,000 for the six months ended June 30, 2012 and 2011, respectively.

Table of Contents*Interest expense*

Interest expense is nearly all related to interest incurred on our Senior Notes, finance obligations, line of credit and our capital leases. Interest expense for the three months ended June 30, 2012 and 2011 totaled \$253,000 and \$630,000, respectively and \$461,000 and \$1.3 million for the six months ended June 30, 2012 and 2011, respectively. The decreases in interest expense are primarily a result of extinguishments of Senior Notes and finance obligations, partially offset by increased expense related to our line of credit.

Other income, net

Other income, net for the three months ended June 30, 2012 and 2011 totaled \$719,000 and \$220,000, respectively and \$1.2 million and \$409,000 for the six months ended June 30, 2012 and 2011, respectively. The increases in other income, net during the three and six months ended June 30, 2012 are primarily due to increased gift card and Club O rewards breakage.

Income taxes

Our provision for income taxes for the three months ended June 30, 2012 and 2011 totaled \$42,000 and \$16,000, respectively and \$51,000 and \$38,000 for the six months ended June 30, 2012 and 2011, respectively. The provision for income taxes is for minimum state tax payments, foreign taxes and certain income tax uncertainties, including penalties and interest.

Seasonality

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

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

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

Liquidity and Capital Resources*Current sources of liquidity*

While we believe that the cash and cash equivalents currently on hand, amounts available under our credit facility and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months; we may require additional financing. Our \$20 million credit facility with U.S. Bank is scheduled to terminate on December 31, 2012. Although we have \$20 million on deposit with U.S. Bank, and may repay and terminate the facility, we may attempt to renegotiate the facility or replace it. There can be no assurance we will be able to do so. There can be no assurance that if additional financing is necessary it will be available, or, if available, that such financing can be obtained on satisfactory terms. Failure to generate sufficient revenues, profits or to raise additional capital could have a material adverse effect on our operations and on our ability to achieve our intended business objectives. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

Our principal sources of liquidity are cash flows generated from operations, and our existing cash and cash equivalents. At June 30, 2012, our cash and cash equivalents balance was \$60.0 million.

Cash flow information is as follows:

	Six months ended June 30,		Twelve months ended June 30,	
	2012	2011	2012	2011
Cash provided by (used in):				
Operating activities	\$ (29,941)	\$ (23,536)	\$ 19,258	\$ 32,724
Investing activities	(6,355)	(4,103)	(11,157)	(11,823)
Financing activities	(691)	(13,702)	(30,783)	(14,229)

Free Cash Flow.

Free Cash Flow (a non-GAAP measure) for the six months ended June 30, 2012 and 2011, was \$(36.4) million and \$(27.6)

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million, respectively and \$8.0 million and \$23.0 million for the twelve months ended June 30, 2012 and 2011, respectively. See **Non-GAAP Financial Measures** below for a reconciliation of Free Cash Flow to net cash provided by (used in) operating activities.

Cash flows from operating activities.

For the six months ended June 30, 2012 and 2011, our operating activities resulted in net cash outflows of \$29.9 million and \$23.5 million, respectively.

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

The \$29.9 million of net cash used in operating activities during the six months ended June 30, 2012 was primarily for payments of accounts payable of \$29.7 million following the holiday season, a decrease in accrued liabilities of \$12.4 million and a decrease in deferred revenue of \$3.7 million, partially offset by non-cash depreciation and amortization expense of \$8.1 million, a reduction in accounts receivable of \$3.4 million and net income of \$3.2 million.

The \$23.5 million of net cash used in operating activities during the six months ended June 30, 2011 was primarily for payments of accounts payable of \$28.5 million following the holiday season, a decrease in accrued liabilities of \$8.8 million and net loss of \$8.2 million, partially offset by a decrease of \$11.0 million in inventories and a reduction in accounts receivable of \$6.9 million.

Cash flows from investing activities.

For the six months ended June 30, 2012 and 2011, investing activities resulted in net cash outflows of \$6.4 million and \$4.1 million, respectively, resulting primarily from expenditures for fixed assets.

Cash flows from financing activities.

For the six months ended June 30, 2012 and 2011, financing activities resulted in net cash outflows of \$691,000 and \$13.7 million, respectively.

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The \$691,000 used in financing activities during the six months ended June 30, 2012 resulted primarily from \$464,000 for the purchase of shares of our common stock withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants.

The \$13.7 million used in financing activities during the six months ended June 30, 2011 resulted primarily from \$10.1 million used for retirement of long-term debt, \$2.1 million in payments on finance obligations and \$1.6 million for the purchase of shares of our common stock withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants.

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

Contractual Obligations	Remainder of 2012	Payments Due by Period					Thereafter	Total
		2013	2014	2015	2016			
Line of credit	17,000							17,000
Interest on line of credit	234							234
Operating leases	4,277	8,206	8,404	6,814	1,381	183		29,265
Naming rights	1,263	1,273	1,311	1,351	1,391			6,589
Purchase obligations	17,626	205						17,831
Total contractual cash obligations	\$ 40,400	\$ 9,684	\$ 9,715	\$ 8,165	\$ 2,772	\$ 183		\$ 70,919

Other Commercial Commitments	Amounts of Commitment Expiration Per Period					Thereafter	Total
	2012	2013	2014	2015	2016		
Letters of credit	\$ 2,028	\$	\$	\$	\$	\$	\$ 2,028

Naming Rights

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

Purchase obligations

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

Tax Contingencies

Our contractual obligations presented above exclude unrecognized tax contingencies, including interest and penalties, of \$323,000 for which we cannot make a reasonably reliable estimate of the amount and period of payment.

Recommendation Algorithm Development Costs

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

Borrowings

U.S. Bank Financing Agreements

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

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

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

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

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

Amounts outstanding under the Financing Agreement were \$17.0 million at June 30, 2012 and December 31, 2011, and letters of credit totaling \$2.0 million and \$2.0 million, respectively, were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets. At June 30, 2012, we had \$20.0 million in compensating cash balances held at U.S. Bank. If we draw on the \$20.0 million compensating cash balance, it will constitute a triggering event and result in additional and more restrictive covenants.

U.S. Bank Commercial Purchasing Card Agreement

We have a commercial purchasing card (the Purchasing Card) agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At June 30, 2012, \$2.9 million was outstanding and \$2.1 million was available under the Purchasing Card. At December 31, 2011, \$3.4 million was outstanding and \$1.6 million was available under the Purchasing Card.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

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

Non-GAAP Financial Measures

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

Contribution and Contribution Margin.

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

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

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

	Three months ended June 30,				Six months ended June 30,			
	2012		2011		2012		2011	
Total net revenue	\$ 239,536	100%	\$ 234,992	100%	\$ 501,903	100%	\$ 500,462	100%
Cost of goods sold	196,367	82.0%	195,222	83.1%	411,226	81.9%	410,608	82.0%
Gross profit	43,169	18.0%	39,770	16.9%	90,677	18.1%	89,854	18.0%
Less: Sales and marketing expense	13,512	5.6%	13,655	5.8%	27,987	5.6%	29,080	5.8%
Contribution and contribution margin	\$ 29,657	12.4%	\$ 26,115	11.1%	\$ 62,690	12.5%	\$ 60,774	12.1%

Free Cash Flow.

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

	Six months ended June 30,		Twelve months ended June 30,	
	2012	2011	2012	2011
Net cash provided by (used in) operating activities	\$ (29,941)	\$ (23,536)	\$ 19,258	\$ 32,724
Expenditures for fixed assets, including internal-use software and website development	(6,503)	(4,024)	(11,220)	(9,708)
Free cash flow	\$ (36,444)	\$ (27,560)	\$ 8,038	\$ 23,016

Government Regulation

Our services are subject to federal and state consumer protection laws including laws protecting the privacy of consumer information and regulations prohibiting unfair and deceptive trade practices. In particular, under federal and state financial privacy laws and regulations, we must

provide notice to consumers of our policies on sharing non-public information with third parties, advance notice of any changes to our policies and, with limited exceptions, we must give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties. Furthermore, the growth and demand for online commerce could result in more stringent consumer protection laws that impose additional compliance burdens on online companies. These consumer protection laws could result in substantial compliance costs.

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

Factors that May Affect Future Results

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

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Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in under "Risk Factors" in our most recent Annual Report on Form 10-K or herein could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

At June 30, 2012, we had \$62.0 million in cash and cash equivalents including restricted cash. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of \$620,000 on our earnings or loss, or the fair market value or cash flows of these instruments.

At June 30, 2012, we had \$17.0 million outstanding under our short-term debt, and letters of credit totaling \$2.0 million were outstanding under our credit facilities. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of \$190,000 on our earnings or loss, or the fair market value or cash flows of these instruments. We have entered into an interest rate cap agreement with U.S. Bank with an effective date of October 1, 2011 limiting our exposure for one-month LIBOR at 0.5% for the term of the Financing Agreement.

ITEM 4. CONTROLS AND PROCEDURES

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

Evaluation of Disclosure Controls and Procedures

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

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

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors disclosed in Item 1A, (Risk Factors) of our most recently filed Form 10-K which sets forth information relating to important risks and uncertainties that could materially affect our business, financial condition or operating results. The Risk Factors described in our Annual Report on Form 10-K continue to be relevant to an understanding of our business, financial condition and operating results and, accordingly, you should review and consider such Risk Factors in making any investment decision with respect to our securities. An investment in our securities continues to involve a high degree of risk.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

- 31.1 Exhibit 31.1 Certification of Chief Executive Officer
- 31.2 Exhibit 31.2 Certification of Chief Financial Officer
- 32.1 Exhibit 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Exhibit 32.2 Section 1350 Certification of Chief Financial Officer

- 101 The following financial information from our Quarterly Report on Form 10-Q for the second quarter of fiscal 2012, filed with the SEC on July 26, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income (Loss), (iii) Consolidated Statements of Cash Flows, (iv) Consolidated Statements of Stockholders' Equity, and (v) Notes to Consolidated Financial Statements.(1)

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

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SIGNATURE

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

Date: July 26, 2012

OVERSTOCK.COM, INC.

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