OVERSTOCK.COM, INC
Form 10-Q
November 07, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended September 30, 2007
	Or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

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

6350 South 3000 East

Salt Lake City, Utah 84121

(Address, including zip code, of

Registrant s principal executive offices)

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

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

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

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

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

There were 23,805,937 shares of the Registrant s common stock, par value $0.0001, outstanding on November 2, 2007.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets (unaudited)

(in thousands)

		December 31, 2006		September 30, 2007
Assets				
Current assets:				
Cash and cash equivalents	$	126,965	$	74,145
Marketable securities				16,842
Total cash and marketable securities		126,965		90,987
Accounts receivable, net		11,638		7,607
Notes receivable		6,702		1,506
Inventories, net		20,274		22,400
Prepaid inventory		2,241		5,003
Prepaid expense		7,473		10,257
Current assets of held for sale subsidiary		4,718		
Total current assets		180,011		137,760
Property and equipment, net		56,198		33,450
Goodwill		2,784		2,784
Other long-term assets, net		578		197
Notes receivable (Note 4)				4,045
Long-term assets of held for sale subsidiary		16,594		
Total assets	$	256,165	$	178,236
Liabilities and Stockholders Equity				
Current liabilities:				
Accounts payable	$	66,039	$	38,504
Accrued liabilities		40,142		26,499
Capital lease obligations, current		5,074		3,801
Current liabilities of held for sale subsidiary		3,684		
Total current liabilities		114,939		68,804
Capital lease obligations, non-current		3,983		
Other long-term liabilities				3,113
Convertible senior notes		75,279		75,537
Total liabilities		194,201		147,454
Commitments and contingencies (Notes 12 and 13)				
Stockholders equity:				
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2006 and September 30, 2007				
Common stock, $0.0001 par value, 100,000 shares authorized, 25,069 and 25,390 shares issued as of December 31, 2006 and September 30, 2007, respectively		2		2
Additional paid-in capital		325,771		332,899
Accumulated deficit		(198,694)		(238,549)
Treasury stock, 1,654 and 1,609 shares at cost as of December 31, 2006 and September 30, 2007, respectively		(64,983)		(63,435)

Accumulated other comprehensive loss		(132)		(135)
Total stockholders equity		61,964		30,782
Total liabilities and stockholders equity	$	256,165	$	178,236

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

Overstock.com, Inc.

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three months ended September 30, 2006	Three months ended September 30, 2007	Nine months ended September 30, 2006	Nine months ended September 30, 2007
Revenue				
Direct	$ 56,564	$ 39,446	$ 205,044	$ 128,725
Fulfillment partner	100,321	122,484	289,077	340,102
Total revenue	156,885	161,930	494,121	468,827
Cost of goods sold:				
Direct (1)	51,037	33,160	183,213	108,801
Fulfillment partner	84,483	100,509	243,481	280,147
Total cost of goods sold	135,520	133,669	426,694	388,948
Gross profit	21,365	28,261	67,427	79,879
Operating expenses:				
Sales and marketing (1)	17,282	8,835	41,852	28,081
Technology (1)	16,157	14,576	44,478	44,786
General and administrative (1)	11,078	9,724	33,978	30,842
Restructuring				12,283
Total operating expenses	44,517	33,135	120,308	115,992
Operating loss	(23,152)	(4,874)	(52,881)	(36,113)
Interest income	459	1,291	2,989	3,359
Interest expense	(1,096)	(1,029)	(3,638)	(3,085)
Other income, net	(6)	(92)	(7)	(92)
Loss from continuing operations	(23,795)	(4,704)	(53,537)	(35,931)
Loss from discontinued operations	(708)		(2,615)	(3,924)
Net loss	(24,503)	(4,704)	(56,152)	(39,855)
Deemed dividend related to redeemable common stock	(33)		(99)	
Net loss attributable to common shares	$ (24,536)	$ (4,704)	$ (56,251)	$ (39,855)
Net loss per common share basic and diluted:				
Loss from continuing operations	$ (1.16)	$ (0.20)	$ (2.71)	$ (1.52)
Loss from discontinued operations	$ (0.03)	$	$ (0.13)	$ (0.16)
Net loss per common share basic and diluted	$ (1.19)	$ (0.20)	$ (2.84)	$ (1.68)
Weighted average common shares outstanding basic and diluted	20,600	23,726	19,774	23,671

(1) Includes stock-based compensation from options as follows:

Cost of goods sold direct	$	103	$	117	$	308	$	338
Sales and marketing	$	77	$	85	$	225	$	248
Technology	$	173	$	195	$	513	$	560
General and administrative	$	689	$	779	$	2,042	$	2,240

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

Overstock.com, Inc.

Consolidated Statements of Stockholders Equity

and Comprehensive Loss (unaudited)

(in thousands)

	Common stock Shares	Common stock Amount	Additional Paid-in capital	Accumulated Deficit	Treasury stock Shares	Treasury stock Amount	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2006	25,069	$ 2	$ 325,771	$ (198,694)	(1,654)	$ (64,983)	$ (132)	$ 61,964
Exercise of stock options	321		2,182					2,182
Treasury stock issued to employees as compensation			(620)		45	1,548		928
Stock-based compensation from employee options			3,386					3,386
Stock-based compensation to consultants in exchange for services			280					280
Stock-based compensation related to performance shares			1,900					1,900
Comprehensive loss:								
Net loss				(39,855)				(39,855)
Net unrealized gain on marketable securities							2	2
Cumulative translation adjustment							(5)	(5)
Total comprehensive loss								(39,858)
Balance at September 30, 2007	25,390	$ 2	$ 332,899	$ (238,549)	(1,609)	$ (63,435)	$ (135)	$ 30,782

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

Overstock.com, Inc.

Consolidated Statements of Cash Flows (unaudited)

(in thousands)

	Three months ended September 30, 2006	Three months ended September 30, 2007	Nine months ended September 30, 2006	Nine months ended September 30, 2007	Twelve months ended September 30, 2006	Twelve months ended September 30, 2007
Cash flows from operating activities of continuing operations:						
Net loss	$ (24,503)	$ (4,704)	$ (56,152)	$ (39,855)	$ (62,435)	$ (85,469)
Adjustments to reconcile net loss to cash provided by (used in) operating activities of continuing operations:						
Loss from discontinued operations	708		2,615	3,924	3,830	8,191
Depreciation and amortization	7,776	7,080	20,802	22,825	25,447	34,350
Realized gain from marketable securities			(2,085)		(1,095)	
Realized loss on disposition of property and equipment			599	1	2,056	1
Stock-based compensation	1,042	1,176	3,088	3,386	3,095	4,418
Stock-based compensation to consultants for services	(3)	140	31	280	(20)	272
Stock-based compensation relating to performance shares		350		350		350
Treasury stock issued to employees as compensation	67	213	679	928	720	1,036
Amortization of debt discount and deferred financing fees	139	86	417	258	435	258
Restructuring				12,283		17,957
Gain from retirement of convertible senior notes					(1,988)	
Notes receivable accretion		(136)		(136)		(136)
Changes in operating assets and liabilities, net of effect of acquisition and discontinued operations:						
Accounts receivable, net	1,541	335	2,880	3,731	(461)	(1,201)
Inventories, net	6,040	(6,975)	24,487	(2,126)	29,352	40,396
Prepaid inventory	(781)	(2,879)	5,605	(2,762)	8,578	(979)
Prepaid expenses	455	(1,522)	(716)	(2,784)	22	(1,064)
Other long-term assets, net	(123)	100	(105)	366	(1,821)	967
Accounts payable	11,745	4,960	(53,479)	(27,632)	(358)	(9,353)
Accrued liabilities	(3,339)	(566)	(26,908)	(18,680)	(25,837)	(3,689)
Other long-term liabilities		(114)		(114)		(114)
Net cash provided by (used in) operating activities of continuing operations	764	(2,456)	(78,242)	(45,757)	(20,480)	6,191
Cash flows from investing activities of continuing operations:						
Change in restricted cash			253		633	
Purchases marketable securities		(7,783)		(29,164)	(2,000)	(29,164)
Sales of marketable securities		8,924	56,756	12,324	76,280	12,324
Expenditures for property and equipment	(7,769)	(316)	(19,675)	(2,232)	(27,851)	(5,998)

Proceeds from the sale property and equipment	1		1		1	
Proceeds from the sale of discontinued operations, net of cash transferred				9,892		9,892
Decrease in cash resulting from deconsolidation of variable interest entity						(102)
Payments received on note receivable		502		5,196		5,196
Expenditures for other long-term assets			(100)		(100)	
Net cash provided by (used in) investing activities of continuing operations	(7,768)	1,327	37,235	(3,984)	46,963	(7,852)
Cash flows from financing activities of continuing operations:						
Payments on capital lease obligations	(124)	(5)	(2,878)	(5,256)	(6,730)	(5,335)
Drawdown on line of credit	5,245		78,503	1,169	86,003	9,347
Payments on line of credit	(5,245)		(78,503)	(1,169)	(90,371)	(9,347)
Payments to retire convertible senior notes					(7,735)	
Proceeds from the issuance of common stock			25,000		25,000	39,406
Exercise of stock options	806	261	2,267	2,182	2,701	2,449
Net cash provided by (used in) financing activities of continuing operations	682	256	24,389	(3,074)	8,868	36,520
Effect of exchange rate changes on cash	40	(26)	11	(5)	(14)	18
Cash provided by (used in) operating activities discontinued operations	42		112	(204)	67	1,265
Cash used in investing activities of discontinued operations	(39)		(343)	(53)	(441)	(276)
Net increase (decrease) in cash and cash equivalents	(6,279)	(899)	(16,838)	(53,077)	39,963	35,866
Change in cash and cash equivalents from discontinued operations	(3)		231	257	374	(989)
Cash and cash equivalents, beginning of period	45,550	75,044	55,875	126,965	3,931	39,268
Cash and cash equivalents, end of period	$ 39,268	$ 74,145	$ 39,268	$ 74,145	$ 39,268	$ 74,145
Supplemental disclosure of cash flow information:						
Interest paid	192	142	2,001	2,378	4,540	4,054
Supplemental disclosures of non-cash flow information:						
Deemed dividend on redeemable common shares	33		99		144	33
Lapse of rescission rights	2,431		3,304		3,450	
Equipment and software acquired under capital leases			2,274		2,322	

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

Overstock.com, Inc.

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Overstock.com, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited annual consolidated financial statements and related notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2006. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and nine months ended September 30, 2007 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 the accounts of the Company and its wholly-owned subsidiaries. The consolidated financial statements include the accounts of the Company s OTravel subsidiary through April 25, 2007 (Note 4). The consolidated financial statements also include the accounts of a variable interest entity for which the Company was the primary beneficiary through November 30, 2006. All significant 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 management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Internal-Use Software and Website Development

The Company includes in fixed assets the capitalized cost of internal-use software and website development, including software used to upgrade and enhance its Website and processes supporting the Company s business. As required by Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* the Company capitalizes costs incurred during the application development stage of internal-use software and amortizes these costs over the estimated useful life of three years. The Company expenses costs incurred related to design or maintenance of internal-use software as incurred.

During the three months ended September 30, 2006 and 2007, the Company capitalized $7.3 million and $209,000, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $3.6 million and $3.2 million for those respective periods. For the nine months ended September 30, 2006 and 2007, the Company capitalized $19.3 million and $1.7 million, respectively, of costs associated with internal-use software and website development, which are partially offset by amortization of previously capitalized amounts of $9.9 million and $10.3 million for those respective periods.

Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7, *Reporting on Advertising Costs*. As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale 2) based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense included in sales and marketing expenses totaled $17.1 million and $7.8 million during the three months ended September 30, 2006 and 2007, respectively. For the nine months ended September 30, 2006 and 2007, advertising expenses totaled $41.1 million and $25.5 million, respectively.

Stock-based Compensation

As of January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123(R) *Share-based Payment an Amendment of FASB Statements No 123 and 95*, which requires the Company to measure compensation expense for all outstanding unvested share-based awards at fair value and recognize compensation expense over the service period for awards expected to vest. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Management considers many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results may differ substantially from these estimates.

Recent accounting pronouncements

In March 2006, the Emerging Issue Task Force reached a consensus on Issue No. 06-03, *How Taxes Collected from Customers and Remitted to Government Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF No. 06-03). The Company adopted the provisions of EITF No. 06-03 beginning January 1, 2007. The adoption of EITF No. 06-03 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of a full valuation allowance, the Company does not have any unrecognized tax benefits and there is no effect on its financial condition or results of operations as a result of implementing FIN 48. The Company is subject to audit by the IRS and various states for the prior 3 years. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months. The Company s policy is that it recognizes interest and penalties accrued on any unrecognized tax positions as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax positions, nor was any interest expense recognized during the three or nine months ended September 30, 2007.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. The Company will adopt SFAS 157 on January 1, 2008. The Company anticipates that the adoption of SFAS 157 will not have a material impact on the Company s consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for the Company s fiscal year beginning January 1, 2008. The Company anticipates that the adoption of SFAS No. 159 will not have a material impact on the Company s consolidated financial statements.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period s presentation. In addition, the Company has revised its consolidated statements of operations and consolidated statements of cash flows for the three and nine months ended September 30, 2006 to present the loss from discontinued operations and the operating and investing portion of the cash flows attributable to discontinued operations on a separately identifiable basis. The effect of these reclassifications had no impact on net income, total assets, total liabilities, or stockholders equity.

3. RESTRUCTURING EXPENSE

During the fourth quarter of 2006, the Company commenced implementation of 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. There were no restructuring expenses during the third quarter of 2007.

During the fiscal year 2006, the Company recorded $5.7 million of restructuring charges, of which $5.5 million, less the elimination of straight-line rent liability of $913,000, related to costs to terminate a co-location data center lease. Other costs included in the restructuring charge related to $638,000 of accelerated amortization of leasehold improvements in the Company s current office facilities that it is attempting to sublease and $450,000 of costs incurred to return these office facilities to their original condition as required by the Company s lease agreement.

During the first nine months of 2007, the Company accrued $8.0 million of restructuring charges related to the termination of a logistics services agreement, termination and settlement of a lease related to its vacated warehouse facilities in Indiana and abandonment and marketing for sub-lease office and data center space in the current corporate office facilities. During the second quarter of 2007, the Company reached an agreement to terminate the Indiana warehouse facilities lease effective August 15, 2007 for $1.9 million, resulting in a reversal of restructuring expense of approximately $1.0 million.

The Company also recorded an additional $2.4 million of restructuring charges related to accelerated amortization of leasehold improvements located in the abandoned office and co-location data center space and $2.0 million of other restructuring charges, primarily related to consolidation of office space in the current corporate office facilities, relocation of a data center and employee severance.

Restructuring liabilities along with charges to expense, cash payments or accelerated amortization of leasehold improvements associated with the facilities consolidation and restructuring program were as follows (in thousands):

	Balance 12/31/2006	Charges to expense	Cash payment or accelerated amortization	Balance 9/30/2007
Lease and contract termination costs	$ 5,499	$ 9,424	$ (10,139)	$ 4,784
Asset retirement obligation	450		(450)	
Accelerated amortization of leasehold improvements		2,359	(2,359)	
Other restructuring expenses		500	(200)	300
Total	$ 5,949	$ 12,283	$ (13,148)	$ 5,084

4. SALE OF DISCONTINUED OPERATIONS

On July 1, 2005, the Company acquired all the outstanding capital stock of Ski West, Inc. (Ski West) for an aggregate of $25.1 million (including $111,000 of capitalized acquisition related expenses).

Ski West is an on-line travel company whose proprietary technology provides easy consumer access to a large, fragmented, hard-to-find inventory of lodging, vacation, cruise and transportation bargains. The travel offerings are primarily in popular ski areas in the U.S. and Canada, with more recent expansion into the Caribbean and Mexico, as well as cruises. Effective upon the closing, Ski West became a wholly-owned subsidiary of the Company, integrated the Ski West travel offerings with the Company s existing travel offerings and changed its name to OTravel.com, Inc (OTravel).

During the fourth quarter of 2006, in conjunction with the facilities consolidation and restructuring program described in Note 3, management decided to sell OTravel. The Company evaluated its plan to sell OTravel in accordance with SFAS 144, which requires that long-lived assets be classified as held for sale only when certain criteria are met. The Company classified the OTravel assets and liabilities as held for sale as it met these criteria as of December 31, 2006, which include: management s commitment to a plan to sell the assets; availability of the assets for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; assets are being marketed at reasonable prices in relation to their fair value; and unlikelihood that significant changes will be made to the plan to the sell the assets. The travel business is not part of the Company s core business operations and is no longer part of its strategic focus. The results of operations for the subsidiary were included in the fulfillment partner segment prior to being classified as discontinued operations.

The Company also determined that the OTravel subsidiary met the definition of a component of an entity and has been accounted for as a discontinued operation under SFAS 144. The results of operations for this subsidiary have been classified as discontinued operations in all periods presented. In conjunction with the discontinuance of OTravel, the Company performed an evaluation of the goodwill associated with the reporting unit pursuant to SFAS 142 and SFAS 144, *Accounting for the Impairment of Long-Lived Assets* and determined that goodwill of approximately $4.5 million was impaired as of December 31, 2006, based on a non-binding letter of intent from a third party to purchase this business. During the quarter ended March 31, 2007, the Company received a revised offer from this third party to purchase its OTravel business and, in April 2007, the Company completed the sale of OTravel under these revised terms. Accordingly, the Company evaluated its goodwill as of March 31, 2007 and, based on the estimated fair value of the discounted cash flows of the net proceeds from the sale, determined that an additional $3.8 million of goodwill was impaired.

On April 25, 2007, the Company completed the sale of OTravel.com to Castles Travel, Inc., an affiliate of Kinderhook Industries, LLC, and Castles Media Company LLC, for $17.0 million. The Company received cash proceeds, net of cash transferred, of $9.9 million and two $3.0 million promissory notes. The $3.0 million senior note matures three years from the closing date and bears interest, payable quarterly, of 4.0%, 10.0% and 14.0% per year in the first, second and third years, respectively. The $3.0 million junior note matures five years from the closing date and bears interest of 8.0% per year, compounded annually, and is payable in full at maturity.

The following table is a summary of the Company s discontinued operations for the nine months ended September 30, 2006 and the period ended April 25, 2007 (in thousands):

	Nine months ended September 30, 2006	Year-to-date period ended April 25, 2007
Sales	$ 4,780	$ 2,226
Cost of sales	(1,103)	(650)
Gross profit	3,677	1,576
Sales and marketing	(1,312)	(447)
Technology	(377)	(60)
General and administrative	(4,603)	(1,152)
Goodwill impairment		(3,841)
Loss from discontinued operations	$	