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

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended September 30, 2005

Or

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

For the transition period from to

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(Exact name of registrant as specified in its charter)

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

6350 South 3000 East

Salt Lake City, Utah 84121

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

Former address:

6350 South 3000 East

Salt Lake City, Utah 84121

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

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

Yes ý No o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2)

Yes o No ý

There were 19,306,046 shares of the Registrant s common stock, par value $0.0001, outstanding on November 7, 2005.

EXPLANATORY NOTE

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

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

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Overstock.com, Inc.

Consolidated Balance Sheets

(in thousands)

(Unaudited)

	December 31, 2004 (Restated)	September 30, 2005 (Restated)
Assets		
Current assets:		
Cash and cash equivalents	$ 198,678	$ 2,575
Marketable securities	88,802	74,225
Cash, cash equivalents and marketable securities	287,480	76,800
Accounts receivable, net	5,715	7,551
Inventories, net	46,558	98,134
Prepaid inventory	12,322	12,606
Prepaid expenses and other assets	3,444	9,319
Total current assets	355,519	204,410
Restricted cash	1,602	633
Property and equipment, net	16,122	59,561
Goodwill	2,784	13,169
Other long-term assets, net	1,516	15,335
Total assets	$ 377,543	$ 293,108
Liabilities, Redeemable Securities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 64,060	$ 47,070
Accrued liabilities	22,917	45,278
Short-term borrowings		4,368
Capital lease obligations, current	595	6,638
Total current liabilities	87,572	103,354
Capital lease obligations, non-current	743	6,907
Convertible senior notes	116,251	84,596
Total liabilities	204,566	194,857
Commitments and contingencies (Note 14)		
	3,166	3,306

Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of December 31, 2004 and September 30, 2005				
Stockholders equity:				
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of December 31, 2004 and September 30, 2005 respectively Common stock, $0.0001 par value, 100,000 shares authorized, 19,390 and 20,526 shares issued and 19,355 and 18,837 shares outstanding as of December 31, 2004 and September 30, 2005 respectively		2		2
Additional paid-in capital		243,131		250,863
Accumulated deficit		(71,726)		(90,501)
Unearned stock-based compensation		(1,301)		(493)
Treasury stock, 35 and 1,689 shares at cost as of December 31, 2004 and September 30, 2005, respectively		(100)		(65,333)
Accumulated other comprehensive income (loss)		(195)		407
Total stockholders equity		169,811		94,945
Total liabilities, redeemable securities and stockholders equity	$	377,543	$	293,108

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, 2004 (Restated)	Three months ended September 30, 2005 (Restated)	Nine months ended September 30, 2004 (Restated)	Nine months ended September 30, 2005 (Restated)
Revenue				
Direct	$ 43,928	$ 68,449	$ 123,621	$ 196,397
Fulfillment partner	59,516	100,874	149,693	289,445
Total revenue	103,444	169,323	273,314	485,842
Cost of goods sold				
Direct	38,491	59,170	109,995	168,992
Fulfillment partner	51,103	83,589	131,010	242,821
Total cost of goods sold	89,594	142,759	241,005	411,813
Gross profit	13,850	26,564	32,309	74,029
Operating expenses:				
Sales and marketing	9,398	17,960	20,380	49,280
Technology	2,268	8,082	5,469	18,271
General and administrative	5,108	9,989	13,725	24,853
Amortization (reversal) of stock-based compensation	18	(8)	276	65
Total operating expenses	16,792	36,023	39,850	92,469
Operating loss	(2,942)	(9,459)	(7,541)	(18,440)
Interest income and other	168	(1,690)	393	(150)
Interest expense	(77)	(1,264)	(139)	(4,226)
Other income, net	3	11	5	4,181
Net loss	(2,848)	(12,402)	(7,282)	(18,635)
Deemed dividend related to redeemable common stock	(47)	(47)	(141)	(140)
Net loss attributable to common shares	$ (2,895)	$ (12,449)	$ (7,423)	$ (18,775)
Net loss per common share basic and diluted	$ (0.16)	$ (0.66)	$ (0.43)	$ (0.96)
Weighted average common shares outstanding basic and diluted	18,284	18,844	17,517	19,468

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

Overstock.com, Inc.
Consolidated Statements of Stockholders Equity
and Comprehensive Income (unaudited)

(amounts in thousands)

	Common stock Shares	Common stock Amount	Additional Paid-in Capital	Accumulated deficit	Unearned stock-based compensation	Treasury stock Shares	Treasury stock Amount	Accumulated Other Comprehensive Income (loss)	Total
Balance at December 31, 2004 (Restated)	19,390	$ 2	$ 243,131	$ (71,726)	$ (1,301)	(35)	$ (100)	$ (195)	$ 169,811
Exercise of stock options and warrants	1,136		6,881						6,881
Issuance of common stock from treasury			381			8	21		402
Purchase of treasury stock						(665)	(24,133)		(24,133)
Purchased call options for purchase of treasury stock			(47,507)						(47,507)
Settlement of purchased call options in exchange for cash			7,937						7,937
Settlement of purchased call options in exchange for treasury stock			41,121			(997)	(41,121)		
Forfeitures of unearned stock-based compensation from options issued to employees			(56)		56				
Amortization of stock-based compensation					65				65
Stock-based compensation to consultants in exchange for services			(1,025)		687				(338)
Deemed dividend related to redeemable common stock				(140)					(140)
Comprehensive income (loss):									
Net loss				(18,635)					(18,635)
Unrealized gain on marketable securities								491	491
Cumulative translation adjustment								111	111
Total comprehensive loss									(18,033)
Balance at September 30, 2005 (Restated)	20,526	$ 2	$ 250,863	$ (90,501)	$ (493)	(1,689)	$ (65,333)	$ 407	$ 94,945

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, 2004 (Restated)	Three months ended September 30, 2005 (Restated)	Nine months ended September 30, 2004 (Restated)	Nine months ended September 30, 2005 (Restated)	Twelve months ended September 30, 2004 (Restated)	Twelve months ended September 30, 2005 (Restated)
Cash flows from operating activities:						
Net loss	$ (2,848)	$ (12,402)	$ (7,282)	$ (18,635)	$ (10,236)	$ (15,893)
Adjustments to reconcile net loss to cash provided by (used in) operating activities						
Depreciation and amortization	1,061	4,901	2,707	9,466	3,429	10,696
Realized (gain) loss from marketable securities	(1)	2,776	(1)	2,361	(2)	2,749
Loss on disposition of property and equipment						34
Amortization of unearned stock-based compensation	18	(8)	276	65	438	149
Stock options issued to consultants for services	25	(312)	594	(338)	701	(43)
Issuance of common stock from treasury		91		402		402
Amortization of debt discount and deferred financing fees		179		602		749
Gain from retirement of convertible senior notes				(4,170)		(4,170)
Changes in operating assets and liabilities:						
Accounts receivable	4,101	(968)	7,705	(965)	5,200	(4,201)
Inventories	(4,046)	(36,587)	(5,066)	(51,576)	(10,238)	(62,325)
Prepaid inventory	(5,137)	(2,196)	3,059	(284)	(1,584)	(284)
Prepaid expenses and other assets	(2,980)	(1,124)	(13,606)	(5,760)	(3,336)	(6,337)
Other long-term assets, net	102	(424)	(1,268)	(435)	(1,149)	(523)
Accounts payable	954	6,663	(7,887)	(17,911)	14,041	23,674
Accrued liabilities	7,824	19,503	8,419	21,997	12,268	27,177
Net cash provided by (used in) operating activities	(927)	(19,908)	(12,350)	(65,181)	9,532	(28,146)
Cash flows from investing activities:						
(Increase) decrease in restricted cash		200	(1,875)	969	(1,875)	1,242
Investments in marketable securities	(15,675)	(21,552)	(27,917)	(183,543)	(29,920)	(248,503)
Sales of marketable securities	1,470	34,062	3,944	196,250	12,206	207,679
Expenditures for property and equipment	(3,805)	(12,190)	(5,404)	(36,466)	(7,744)	(39,796)
Acquisition of Ski West (net of cash acquired)		(24,620)		(24,620)		(24,620)
Proceeds from the sale of property and equipment						20
Expenditures for other long-term assets					(172)	
Net cash used in investing activities	(18,010)	(24,100)	(31,252)	(47,410)	(27,505)	(103,978)
Cash flows from financing activities:						
Payments on capital lease obligations	(153)	(182)	(507)	(3,234)	(532)	(3,386)
Borrowings on line of credit		4,368	1,000	4,368	1,000	4,368
Payments on line of credit						(1,000)
Issuance of common stock, net of issuance costs			37,857		37,857	75,207
Issuance of convertible senior notes						116,251
Payments to retire convertible senior notes				(27,935)		(27,935)
Purchased call options for purchase of treasury stock				(47,507)		(47,507)
Settlement of call options for cash		7,937		7,937		7,937
Purchase of treasury stock				(24,133)		(24,133)
Exercise of stock options and warrants	596	2,973	3,555	6,881	3,848	7,615
Net provided by (used in) financing activities	443	15,096	41,905	(83,623)	42,173	107,417

Effect of exchange rate changes on cash	2	137	7	111	6	126
Net increase (decrease) in cash and cash equivalents	(18,492)	(28,775)	(1,690)	(196,103)	24,206	(24,581)
Cash and cash equivalents, beginning of period	45,648	31,350	28,846	198,678	2,950	27,156
Cash and cash equivalents, end of period	$ 27,156	$ 2,575	$ 27,156	$ 2,575	$ 27,156	$ 2,575
Supplemental cash flow information:						
Interest paid	$ 77	$ 76	$ 139	$ 2,569	$ 146	$ 2,595
Deemed dividend on redeemable common shares	$ 47	$ 47	$ 141	$ 140	$ 190	$ 187
Forfeitures on unearned stock-based compensation	$ 105	$ 10	$ 192	$ 56	$ 267	$ 64
Settlement of purchased call options for treasury stock	$	$	$	$ 41,121	$	$ 41,121
Equipment and software acquired under capital leases	$	$ 193	$ 1,835	$ 15,390	$ 120	$ 15,390
Supplemental disclosure of non-cash activities:						
Fair value of assets acquired, net of cash acquired	$	$ 25,956	$	$ 25,956	$	$ 25,956
Fair value of liabilities assumed		(1,336)		(1,336)		(1,336)
Cash paid to purchase businesses	$	$ 24,620	$	$ 24,620	$	$ 24,620

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, 2004. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of results for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates. The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

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

2. RESTATEMENT OF FINANCIAL STATEMENTS

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

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

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

Based upon this determination, the consolidated balance sheets as of December 31, 2004 and September 30, 2005 and the consolidated statements of operations for the quarters ended September 30, 2005 and 2004 contained herein have been restated. As the restatement adjustments decrease the net loss by $1.7 million and $103,000 for the quarters ended September 30, 2005 and 2004, respectively, and increase inventory by the corresponding amount, there has been no impact on net cash used in operating activities the consolidated statements of cash flows. The restated consolidated statements of operations and balance sheets have been restated as follows:

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three Months Ended September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 68,449		$ 68,449
Fulfillment partner	100,874		100,874
Total revenue	169,323		169,323
Cost of goods sold			
Direct	60,939	(1,769)	59,170
Fulfillment partner	83,589		83,589
Total cost of goods sold	144,528	(1,769)	142,759
Gross profit	24,795	1,769	26,564
Operating expenses:			
Sales and marketing	17,960		17,960
Technology	8,082		8,082
General and administrative	9,989		9,989
Amortization of stock-based compensation	(8)		(8)
Total operating expenses	36,023		36,023
Operating loss	(11,228)	1,769	(9,459)
Interest income	(1,690)		(1,690)
Interest expense	(1,264)		(1,264)
Other income, net	11		11
Net loss	(14,171)	1,769	(12,402)
Deemed dividend related to redeemable common shares	(47)		(47)
Net loss attributable to common shares	$ (14,218)	$ 1,769	$ (12,449)
Net loss per common share basic and diluted	$ (0.75)	$ 0.09	$ (0.66)
Weighted average common shares outstanding basic and diluted	18,844		18,844

Consolidated Statements of Operations (unaudited)

(in thousands, except per share data)

	Three Months Ended September 30, 2004		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 43,928		$ 43,928
Fulfillment partner	59,516		59,516
Total revenue	103,444		103,444
Cost of goods sold			
Direct	38,594	(103)	38,491
Fulfillment partner	51,103		51,103
Total cost of goods sold	89,697	(103)	89,594
Gross profit	13,747	103	13,850
Operating expenses:			
Sales and marketing	9,398		9,398
Technology	2,268		2,268
General and administrative	5,108		5,108
Amortization of stock-based compensation	18		18
Total operating expenses	16,792		16,792
Operating loss	(3,045)	103	(2,942)
Interest income	168		168
Interest expense	(77)		(77)
Other income, net	3		3
Net loss	(2,951)	103	(2,848)
Deemed dividend related to redeemable common shares	(47)		(47)
Net loss attributable to common shares	$ (2,998)	$ 103	$ (2,895)
Net loss per common share basic and diluted	$ (0.16)	$ 0.00	$ (0.16)
Weighted average common shares outstanding basic and diluted	18,284		18,284

	Nine Months Ended September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 196,397		$ 196,397
Fulfillment partner	289,445		289,445
Total revenue	485,842		485,842
Cost of goods sold			
Direct	171,246	(2,254)	168,992
Fulfillment partner	242,821		242,821
Total cost of goods sold	414,067	(2,254)	411,813
Gross profit	71,775	2,254	74,029
Operating expenses:			
Sales and marketing	49,280		49,280
Technology	18,271		18,271
General and administrative	24,853		24,853
Amortization of stock-based compensation	65		65
Total operating expenses	92,469		92,469
Operating loss	(20,694)	2,254	(18,440)
Interest income	(150)		(150)
Interest expense	(4,226)		(4,226)
Other income, net	4,181		4,181
Net loss	(20,889)	2,254	(18,635)
Deemed dividend related to redeemable common shares	(140)		(140)
Net loss attributable to common shares	$ (21,029)	$ 2,254	$ (18,775)
Net loss per common share basic and diluted	$ (1.08)	$ 0.12	$ (0.96)
Weighted average common shares outstanding basic and diluted	19,468		19,468

	Nine Months Ended September 30, 2004		
	As Previously Reported	Adjustment	As Restated
Revenue			
Direct	$ 123,621		$ 123,621
Fulfillment partner	149,693		149,693
Total revenue	273,314		273,314
Cost of goods sold			
Direct	110,196	(201)	109,995
Fulfillment partner	131,010		131,010
Total cost of goods sold	241,206	(201)	241,005
Gross profit	32,108	201	32,309
Operating expenses:			
Sales and marketing	20,380		20,380
Technology	5,469		5,469
General and administrative	13,725		13,725
Amortization of stock-based compensation	276		276
Total operating expenses	39,850		39,850
Operating loss	(7,742)	201	(7,541)
Interest income	393		393
Interest expense	(139)		(139)
Other income, net	5		5
Net loss	(7,483)	201	(7,282)
Deemed dividend related to redeemable common shares	(141)		(141)
Net loss attributable to common shares	$ (7,624)	$ 201	$ (7,423)
Net loss per common share basic and diluted	$ (0.44)	$ 0.01	$ (0.43)
Weighted average common shares outstanding basic and diluted	17,517		17,517

Consolidated Balance Sheets

(in thousands)

(Unaudited)

	As of September 30, 2005 As Previously Reported		As Restated	
Assets				
Current assets:				
Cash and cash equivalents	$	2,575	$	2,575
Marketable securities		74,225		74,225
Cash, cash equivalents and marketable securities		76,800		76,800
Accounts receivable, net		7,551		7,551
Inventories, net		94,601		98,134
Prepaid inventory		12,606		12,606
Prepaid expenses		9,319		9,319
Total current assets		200,877		204,410
Restricted cash		633		633
Property and equipment, net		59,561		59,561
Goodwill		13,169		13,169
Other long-term assets, net		15,335		15,335
Total assets	$	289,575	$	293,108
Liabilities, Redeemable Securities and Stockholders Equity				
Current liabilities:				
Accounts payable		47,070		47,070
Accrued liabilities		45,278		45,278
Short-term borrowings		4,368		4,368
Capital lease obligations, current		6,638		6,638
Total current liabilities		103,354		103,354
Capital lease obligations, non-current		6,907		6,907
Convertible senior notes		84,596		84,596
Total liabilities		194,857		194,857
Redeemable common stock, $0.0001 par value, 460 shares issued and outstanding as of March 31, 2005		3,306		3,306
Stockholders equity:				
Preferred stock, $0.0001 par value, 5,000 shares authorized, no shares issued and outstanding as of March 31, 2005				
Common stock, $0.0001 par value, 100,000 shares authorized, 19,491 shares issued as of March 31, 2005		2		2
Additional paid-in capital		250,863		250,863
Accumulated deficit		(94,034)		(90,501)
Unearned stock-based compensation		(493)		(493)
Treasury stock, 31 shares at cost as of March 31, 2005		(65,333)		(65,333)
Accumulated other comprehensive loss		407		407

Total stockholders equity		91,412		94,945
Total liabilities, redeemable securities and stockholders equity	$	289,575	$	293,108

Consolidated Balance Sheets

(in thousands)

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

3. ACCOUNTING POLICIES

Derivative instruments

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

Advertising expense

The Company recognizes advertising expenses in accordance with SOP 93-7 *Reporting on Advertising Costs*. As such, the Company expenses the costs of producing advertisements at the time production occurs or the first time the advertising takes place, and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) during the period customers are acquired; or 2) based on the number of clicks generated during a given period over the term of the contract. Advertising expense included in sales and marketing expenses totaled $9.0 million and $17.2 million during the three months ended September 30, 2004 and 2005, respectively, and $19.5 million and $47.7 million during the nine months ended September 30, 2004 and 2005, respectively.

Asset Retirement Obligation

In accordance with SFAS No. 143, Accounting for Asset Retirement Obligations, the Company establishes assets and liabilities for the present value of estimated future costs to return certain of our leased facilities to their original condition. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated restoration costs. At September 30, 2005, such amounts are not significant.

Accounting for merchant and agency revenues for Travel subsidiary

The determination of gross versus net revenue presentation is based principally on the Company s consideration of Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements and Emerging Issues Task Force Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, including the weighing of the relevant qualitative factors regarding the Company s status as the primary obligor, and the extent of pricing latitude and inventory risk. The method of merchant revenue presentation by the Company does not impact operating profit, net income, or cash flows, but rather revenues and cost of sales.

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The principle factor in determining gross versus net presentation by the Company s travel subsidiary, OTravel.com, Inc. (OTravel.com see Note 5) is the consideration of who is the primary obligor in the relationship with the customer. Our Travel business provides extensive customer service and support for its customers; however, the supplier hotel is principally liable to its merchant hotel customers in all situations where the customer does not receive the hotel services booked through OTravel.com. In this case, OTravel.com provides customer service support to help resolve issues, even though such customer support could typically involve issues for which OTravel.com is not principally liable.

OTravel.com generates both merchant hotel revenues and agency air, hotel, car and cruise revenues. Merchant hotel revenues are recognized as net revenue at the time of booking since all transactions are billed directly to customers, are nonrefundable and generally noncancelable, and require no significant post-delivery obligations for OTravel.com. A reserve for chargebacks and cancellations is recorded at the time of the transaction based on historical experience.

Agency revenues are derived from airline ticket transactions, certain hotel transactions as well as cruise and car rental reservations. Agency revenues are recognized on a net basis on air transactions when the reservation is made and secured by a credit card. A cancellation allowance is recognized on these revenues based on historical experience. OTravel.com recognizes agency revenues on hotel reservations, cruise and car rental reservations, either on an accrual basis for payments from a commission clearinghouse or on receipt of commissions from an individual supplier.

Recent accounting pronouncements

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

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

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

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

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

4. MARKETABLE SECURITIES

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

	Cost Basis	Recognized Loss On Derivative Securities	Unrealized Gains (Losses)	Fair Value
U.S. government and government agency securities	$ 23,997	$	$ (165)	23,832
Mortgage-backed securities	2,150		(4)	2,146
Foreign corporate securities	49,937	(2,350)	660	48,247
Total	$ 76,084	$ (2,350)	$ 491	$ 74,225

All marketable securities mature between 2005 and 2034 and are classified as available-for-sale securities. Available-for-sale securities are classified as current as they are deemed available for use, if needed for current operations.

Derivative instruments

During the first quarter of 2005, the Company purchased $49.9 million of Foreign Corporate Securities (Notes) which fully mature for $50.0 million in cash in November 2006. The Notes do not have a stated interest rate, but are structured to return the entire principal amount and a conditional coupon if held to maturity. The conditional coupon will provide a rate of return dependent on the performance of a basket of eight Asian currencies against the U.S. dollar. If the Company redeems the Notes prior to maturity, the Company may not realize the full amount of its initial investment. At September 30, 2005, the Notes had a fair value of $48.2 million.

Under SFAS No. 133, the Notes are considered to be derivative financial instruments and are marked to market quarterly. Any unrealized gain or loss related to the changes in value of the conditional coupon is recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the changes in the value of the Notes is recorded as a component of other comprehensive income (loss).

For the quarter and nine months ended September 30, 2005 changes in the value of the conditional coupon resulted in losses of $2.1 million and $2.4, respectively. The changes in the value of the Notes resulted in a gain of $660,000 which was recorded as a component of other comprehensive income (loss) for the quarter and nine months ended September 30, 2005.

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

5. ACQUISITIONS

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). In addition, the Company may be subject to additional earn out payments (based on a percentage of operating profits for each of the next four years as follows: 50%, 33.3%, 20%, and 10%, respectively), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005 among the Company, Ski West, and all of the shareholders of Ski West.

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.

Purchase Price Allocations

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on July 1, 2005. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in estimates of the fair value of assets acquired and liabilities assumed (in thousands):

		July 1, 2005
Cash	$	491
Current assets		986
Property and equipment		263
Goodwill		10,385
Intangible assets		14,313
Other assets		9
Assets acquired		26,447
Liabilities assumed		(1,336)
Net assets acquired	$	25,111

The excess of the purchase price over the fair values of assets acquired and liabilities assumed was allocated to goodwill. Any required earn out payments would further increase goodwill at the time the target operating results for the next four years are successfully achieved. Of the $10,385 recorded in goodwill, the full amount is expected to be deductible for tax purposes, to the extent the Company has sufficient taxable income in the future.

The amounts allocated to intangible assets, and their estimated useful lives, were based on independent appraisal and were attributed to the following categories (in thousands):

			Years
Enterprise information system	$	860	5
Customer list		2,339	4
Supplier contracts		6,271	12
Web sites and destination portal		2,887	5
Non-competition agreements		1,956	2
	$	14,313	

During the quarter ended September 30, 2005, the Company recorded amortization expense attributable to the above intangible assets of approximately $700,000.

Pro forma results of operations have not been presented because the effect of the acquisition was not material to the results of prior periods presented.

6. COMPREHENSIVE INCOME (LOSS)

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

	Three months ended September 30,		Nine months ended September 30,	
	2004 (Restated)	2005 (Restated)	2004 (Restated)	2005 (Restated)

Net loss	$ (2,848)	$ (12,402)	$ (7,282)	$ (18,635)
Net unrealized gain (loss) on marketable securities	6	312	(56)	(169)
Unrealized gain on foreign bonds		660		660
Foreign currency translation adjustment	2	137	7	111
Comprehensive loss	$ (2,840)	$ (11,293)	$ (7,331)	$ (18,033)

7. NET LOSS PER SHARE

Basic earnings (loss) per share is computed by dividing net income (loss) attributable to common shares for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, composed of incremental common shares issuable upon the exercise of stock options, warrants and convertible senior notes, are included in the calculation of diluted net loss per share to the extent such shares are dilutive. During the three- and nine-month periods ended September 30, 2004 and 2005, the effects of outstanding stock options, warrants and convertible senior notes were antidilutive and accordingly, have been excluded from diluted loss per share. There were 1.3 million options and no warrants outstanding at September 30, 2005. As of September 30, 2005, the Company had $87.0 million of convertible senior notes outstanding (Note 13), which could potentially convert into 1.2 million shares of common stock in the aggregate.

8. BUSINESS SEGMENTS

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

	Three months ended September 30,			Nine months ended September 30,		
	Direct operations	Fulfillment partner operations	Consolidated	Direct operations	Fulfillment partner operations	Consolidated
2004 (Restated)						
Revenue	$ 43,928	$ 59,516	$ 103,444	$ 123,621	$ 149,693	$ 273,314
Cost of goods sold	38,491	51,103	89,594	109,995	131,010	241,005
Gross profit	$ 5,437	$ 8,413	13,850	$ 13,626	$ 18,683	32,309
Operating expenses			(16,792)			(39,850)
Other income (expense), net			94			259
Net loss			$ (2,848)			$ (7,282)
2005 (Restated)						
Revenue	$ 68,449	$ 100,874	$ 169,323	$ 196,397	$ 289,445	$ 485,842
Cost of goods sold	59,170	83,589	142,759	168,992	242,821	411,813
Gross profit	$ 9,279	$ 17,285	26,564	$ 27,405	$ 46,624	74,029
Operating expenses			(36,023)			(92,469)
Other income, net			(2,943)			(195)
Net loss			$ (12,402)			$ (18,635)

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

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

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

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

9. PUBLIC OFFERINGS

In June 2004, the Company closed its second follow-on public offering, pursuant to which it sold 1.3 million shares of common stock, with proceeds to the Company of approximately $37.9 million, net of $405,000 of issuance costs.

In November 2004, the Company closed an additional follow-on public offering, pursuant to which it sold 1.4 million shares of common stock, with proceeds to the Company of approximately $75.2 million, net of $215,000 of issuance costs. Concurrently in November 2004, the Company issued convertible senior notes pursuant to which it received $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs.

10. STOCK-BASED COMPENSATION

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

	Three months ended September 30, 2004 (Reported)	Three months ended September 30, 2005 (Reported)	Nine months ended September 30, 2004 (Reported)	Nine months ended September 30, 2005 (Reported)
Net loss, as reported	$ (2,848)	$ (12,402)	$ (7,282)	$ (18,635)
Add: Stock-based employee compensation expense included in reported net income	18	(8)	276	65
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(710)	(1,033)	(2,654)	(2,948)
Pro forma net loss	$ (3,540)	$ (13,443)	$ (9,660)	$ (21,518)
Net loss per common share				
Basic and diluted - as reported	$ (0.16)	$ (0.66)	$ (0.43)	$ (0.96)
Basic and diluted - pro forma	$ (0.20)	$ (0.71)	$ (0.55)	$ (1.11)

The fair value of options granted is estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. We use the historical stock price volatility of our common stock over the most recent period that is generally commensurate with the expected option life as the basis for estimating stock price volatility. For options granted during the three months ended September 2005, the historical stock price volatility used was based on a daily stock price observation, using the closing price, which resulted in an expected stock price volatility of 76.43%. For purpose of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods. Effective January 1, 2006, the Company will record stock compensation expense in accordance with FAS 123R.

11. SHARE BUYBACK PROGRAM

During January 2005, the Company s Board of Directors authorized a stock repurchase program under which the Company was authorized to repurchase up to $50.0 million of its common stock through December 31, 2007. On April 26, 2005, the Board of Directors increased the amount of the stock buyback program to $100.0 million. Additionally, on June 14, 2005, the Board of Directors authorized an amendment of its three-year stock repurchase program to include the repurchase of its Convertible Senior Notes.

During 2005, the Company entered into several purchased call options, pursuant to which the Company could have been required to purchase up to 1.3 million shares of its common stock at certain settlement dates during the quarter ended June 30, 2005. In connection with these repurchase transactions; the Company paid approximately $47.5 million, which was recorded in shareholders equity in the consolidated balance sheet.

At the Company s option, the purchased call options were settled in cash or stock, based on the market price of our common stock on the date of the settlement. Upon settlement, the Company either had its capital investment returned with a premium or received shares of its common stock, depending, respectively, on whether the market price of its common stock was above or below a pre-determined price agreed in connection with each such transaction.

Under the buyback program, the Company repurchased approximately 665,000 shares of our common stock in open market transactions for $24.1 million during the nine months ended September 30, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $41.1 million of structured stock repurchase transactions during the nine months ended September 30, 2005. The purchased call options that did not settle in stock settled in cash totaling $7.9 million, which the Company received in July 2005.

12. BORROWINGS

In December 2004, the Company entered into an amendment to a credit agreement (Amended Credit Agreement) with Wells Fargo Bank, National Association. The original credit agreement (originally executed in February 2004) provided the Company with a revolving line of credit for the purpose of issuing up to $10.0 million of letters of credit for the purchase of inventory. As amended to date, the Amended Credit Agreement provides a revolving line of credit to the Company of up to $30.0 million and expires December 31, 2005. The Company has the option to renew the Amended Credit Agreement annually. Included in the $30.0 million Amended Credit Agreement is a $15.0 million sub-limit for a revolving line of credit which the Company uses to obtain letters of credit to support inventory purchases.

At September 30, 2005 $4.4 million was outstanding on the line and letters of credit totaling $6.9 million were issued on our behalf under this facility.

Prior to October 18, 2005, interest on borrowings was payable monthly and accrued at either (i) one-half of one percentage point (0.50%) above LIBOR in effect on the first day of an applicable fixed rate term, or (ii) at a fluctuating rate per annum determined by the bank to be one half a percent (0.50%) above daily LIBOR in effect on each business day a change in daily LIBOR is announced by the bank. Unpaid principal, together with accrued and unpaid interest was due on the maturity date. Borrowings under the facility were collateralized by the Company s cash and marketable securities deposited at Wells Fargo or its affiliates, and the Company was required to maintain balances with Wells Fargo or its affiliates of up to $21.1 million in order to have the full amount of the credit facility available.

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

On October 18, 2005, we entered into a sixth amendment to the credit agreement (Sixth Amended Credit Agreement). The Sixth Amended Credit Agreement eliminated the requirement that the Company maintain specified cash balances with Wells Fargo as a condition to the availability of advances under the facility, and substituted collateral consisting of foreign bond securities owned by the Company in an aggregate principal amount of $50.0 million to secure the Company s obligations under the facility. The $15.0 million sub-limit used to obtain letters of credit to support inventory purchases remained the same. We have an option to renew the Sixth Amended Credit Agreement annually. The Sixth Amendment increased the interest rate on fixed rate advances under the credit facility to 1.35% above LIBOR on the first day of each fixed rate term.

Capital leases

The Company leases certain software and computer equipment under three non-cancelable capital leases that expire at various dates through 2008. The Company expects that in the normal course of business the leases will expire. Software and equipment acquired relating to the capital leases were $1.8 million and $16.3 million at December 31, 2004 and September 30, 2005, respectively, with accumulated depreciation and amortization of $395,000 and $2.9 million at those respective dates. Depreciation of assets recorded under capital leases was zero and $2.5 million for the nine months ended September 30, 2004 and 2005, respectively.

Future minimum lease payments under capital leases are as follows (in thousands):

Year Ending September 30,		
2006	$	7,202
2007		4,634
2008		2,996
2009		
2010		
Total minimum lease payments		14,832
Less: amount representing interest		(1,287)
Present value of capital lease obligations		13,545
Less: current portion		(6,638)
Capital lease obligations, non-current	$	6,907

13. 3.75% CONVERTIBLE SENIOR NOTES

In November 2004, the Company completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes). This includes $20.0 million of additional Senior Notes issued to the initial purchaser upon exercise of its 30-day purchase option to cover over-allotments. Proceeds to the Company were $116.2 million, net of $3.8 million of initial purchaser s discount and debt issuance costs. The discount and debt issuance costs are being amortized using the straight-line method which approximates the interest method. During the three and nine months ended September 30, 2005, the Company recorded amortization of discount and debt issuance costs related to this offering totaling $128,000 and $384,000, respectively. Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year, beginning June 1, 2005. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness.

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

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

Company was in compliance with these covenants at September 30, 2005.

In June 2005, under the Share Buyback Program (see Note 11), the Company retired $33.0 million of its 3.75% Convertible Senior Notes (the Senior Notes), which were due on December 1, 2011 for $27.9 million in cash. As a result of the note retirement, the Company recognized a gain of $4.2 million, net of the associated unamortized discount of $960,000, in other income, in the consolidated statements of operations. As of September 30, 2005, $87.0 million of the Senior Notes remained outstanding. Pursuant to the Share Buyback Program, the Company had initiated the retirement of additional Convertible Senior Notes as of November 8, 2005.

14. COMMITMENTS AND CONTINGENCIES

Through July 2005, the Company leased 43,000 square feet of office space under an operating lease which was originally scheduled to expire in January 2007. However, effective July 2005 this lease was terminated and replaced with a lease for a new office building in the Old Mill Corporate Center III in Salt Lake City, Utah. Pursuant to this agreement, the Company began leasing approximately 143,000 rentable square feet for a term of ten years beginning July 2005. In February 2005, the Company and Old Mill Corporate Center III, LLC (the Lessor) entered into a Tenant Improvement Agreement (the OMIII Agreement) relating to the office building. The OMIII Agreement sets forth the terms on which the Company will pay the costs of certain improvements to the leased office space. The amount of the costs is estimated to be approximately $2.0 million. The OMIII Agreement requires the Company to reimburse the Lessor for the amount of the costs within thirty days after presentation of invoices or written requests for reimbursement. The OMIII Agreement also requires the Company to provide either a cash deposit or a letter of credit in the amount of $500,000 to the Lessor to provide funds for the removal of the improvements upon the termination of the lease. The Company issued a letter of credit for $500,000 to the Lessor.

The Company leases 480,000 square feet for its warehouse facilities in Utah under operating leases which expire in August 2012.

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

Minimum future payments under these operating leases are as follows (in thousands):

Twelve Months Ending September 30,		
2006	$	5,488
2007		6,606
2008		7,143
2009		7,597
2010		7,810
Thereafter		38,152
	$	72,796

Rental expense for operating leases totaled $642,000 and $1.7 million for the three months ended September 30, 2004 and 2005, respectively, and $1.8 million and $3.7 million for the nine months ended September 30, 2004 and 2005, respectively.

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

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

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

In December 2003, the Company received a letter from Furnace Brook claiming that certain of the Company s business practices and the Company s on-line ordering system infringe a patent owned by Furnace Brook. After diligent efforts to show that the Company does not infringe these patents and Furnace Brook s continual assertions that it would vigorously protect its intellectual property rights if the Company did not agree to enter into licensing arrangements with respect to the asserted patents, on August 12, 2005, the Company filed a complaint in the United States District Court of Utah, Central Division, seeking declaratory judgment that the Company does not infringe any valid claim of the Furnace Brook patent. Furnace Brook filed a motion to dismiss the Company s complaint for lack of personal jurisdiction over Furnace Brook in Utah. On October 31, 2005, the United States District Court of Utah, Central Division, issued a decision to dismiss the Company s complaint for lack of personal jurisdiction over Furnace Brook. The Company is currently considering the benefits of motions for reconsideration or appeal of the Utah decision. On August 18, 2005, shortly after the Company filed the complaint in Utah, Furnace Brook filed a complaint in the United States District Court for the Southern District of New York, alleging that certain of the Company s business practices and the Company s on-line ordering system infringe a single patent owned by Furnace Brook. On September 12, 2005, the Company filed a motion to stay the proceedings in New York pending resolution of the issues related to the motion to dismiss in Utah. An answer to the New York complaint is not due until after resolution of the motion to stay. Although the Company believes to have defenses to the infringement allegations in the New York case, which the Company intends to pursue vigorously, the Furnace Brook lawsuit is not yet in the discovery stage, and the Company does not have sufficient information to assess the validity of the claims or the amount of potential damages.

On August 11, 2005, along with a shareholder plaintiff, the Company filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management Company, Inc. and their respective principals, as well as other, as yet unnamed, defendants. The Company, along with a second shareholder plaintiff, filed the complaint in the Superior Court of California, County of Marin. On October 12, 2005, the Company filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. The defendants have been served with, but have not yet answered, the amended complaint. The Company intends to pursue this action vigorously.

15. INDEMNIFICATIONS AND GUARANTEES

During its normal course of business, the Company has made certain indemnities, commitments, and guarantees under which it may be required to make payments in relation to certain transactions. These indemnities include, but are not limited to, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. The duration of these indemnities, commitments, and guarantees varies, and in certain cases, is indefinite. In addition, the majority of these indemnities, commitments, and guarantees do not provide for any limitation of the maximum potential future payments the Company could be obligated to make. As such, the Company is unable to estimate with any reasonableness its potential exposure under these items. The Company has not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets. The Company does, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable. The Company carries specific and general liability insurance policies that the Company believes would, in most circumstances, provide some, if not total recourse to any claims arising from these indemnifications.

16. VARIABLE INTEREST ENTITY

In August 2004, the Company entered into an agreement which allows the Company to lend up to $10.0 million to an entity for the purpose of buying inventory, primarily to supply a new category within our jewelry store which allows customers purchasing diamond rings to select both a specific diamond and ring setting. In November 2004, the Company loaned the entity $8.4 million. The promissory note bears interest at 3.75% per annum. The Company is also entitled to receive fifty percent (50%) of any profits of the entity. Interest is due and payable quarterly on the fifteenth day of February, May, August and November, commencing on November 15, 2004 until the due date of November 30, 2006, on which all principal and interest accrued and unpaid thereon, shall be due and payable. The promissory note is collateralized by all of the assets of the entity.

The Company has a ten year option to purchase (Purchase Option) 50% of the ownership and voting interest of the entity. The exercise price of the Purchase Option is the sum of (a) one thousand dollars, and (b) $3.0 million, which may be paid, at the Company s election, in cash or by the forgiveness of $3.0 million of the entity s indebtedness to the Company.

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

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

		September 30, 2005
Cash	$	257
Accounts receivable		53
Inventory		7,514
Prepaid expenses		11
Property and equipment		237
Total assets	$	8,072

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

Special Note Regarding Forward Looking Statements

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

These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties please see the Factors That May Affect Future Results section of this report. These forward-looking statements speak only as of the date of this report and, except as required by law, we undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report.

Restatement

As discussed in Note 2 to the financial statements, the financial statements for the quarters ended September 30, 2004 and 2005 and the related notes thereto contained in this Amendment No. 1 to the Company s Quarterly Report on Form 10-Q/A for the quarters ended September 30, 2004 and 2005 have been restated in order to properly reflect the capitalization of inbound freight as a component of inventory rather than as a period cost. The cumulative effect of the adjustments for all fiscal years prior to 2002 is to reduce the reported accumulated deficit and to increase inventory by $239,000. The effect of the adjustments on the Consolidated Results of Operations for the years ended December 31, 2002, 2003 and 2004 is to reduce net loss by $241,000, $339,000 and $462,000, respectively. The effect of the adjustment on the consolidated results of operations for the three-month periods ended September 30, 2004 and 2005 is to decrease net loss by $103,000 and $1.8 million, respectively. All amounts in Management s Discussion and Analysis of Financial Condition and Results of Operation have been adjusted, as appropriate, for the effects of the restatement.

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

Overview

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

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

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

During the fourth quarter of 2003, we added a discount travel store to our Website. We used fulfillment partners to supply the travel products and services (flights, hotels, rental cars, etc.). For the first and second quarters of 2004, our revenues from the Travel department were insignificant. During May of 2004, our travel store was closed so we could work to make improvements to the travel product offerings. In January 2005, we re-opened the travel store on our Website. We currently offer air, hotel and car reservation services as well as cruise and vacation packages.

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). In addition, the Company may be subject to additional earn out payments (based on a percentage of operating profits for each of the next four years as follows: 50%, 33.3%, 20%, and 10%, respectively), subject to reduction under certain circumstances, pursuant to a Stock Purchase Agreement dated June 24, 2005 among the Company, Ski West, and all of the shareholders of Ski West.

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.com generates merchant hotel revenues. Merchant hotel revenues at OTravel.com are billed to customers and recognized on a net basis at the time of booking since all transactions are nonrefundable and generally noncancelable and OTravel.com has no significant post-delivery obligations. A reserve for chargebacks and cancellations is recorded at the time of the transaction based on historical experience.

All other revenues are considered agency revenues and relate to the Company s existing travel operations. Agency revenues are derived from airline ticket transactions, certain hotel transactions as well as cruise and car rental reservations. Agency revenues are recognized on a net basis on air transactions when the reservation is made and secured by a credit card. A cancellation allowance is recognized on these revenues based on historical experience. OTravel.com recognizes agency revenues on hotel reservations, cruise and car rental reservations, either on an accrual basis for payments from a commission clearinghouse or on receipt of commissions from an individual supplier.

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

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

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

Sales and marketing expenses consist primarily of advertising, public relations and promotional expenditures, as well as payroll and related expenses for personnel engaged in marketing and selling activities. Advertising expense is the largest component of our sales and marketing expenses and is primarily attributable to expenditures related to online marketing activities and our offline national radio and television advertising. For the three months ended September 30, 2004 and 2005, our advertising expenses totaled approximately $9.2 million and $17.2 million, respectively, representing 96% of sales and marketing expenses for both those respective periods. For the nine months ended September 30, 2004 and 2005, our advertising expenses totaled approximately $19.5 million and $47.7 million, respectively, representing 95% and 98% of sales and marketing expenses for those respective periods. We expect our sales and marketing expenses to increase in future periods on an absolute dollar basis as we expect to continue to increase our advertising efforts.

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

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

Goodwill is not amortized, but is evaluated at least annually for impairment. There was no impairment of goodwill during the nine months ended September 30, 2004 and 2005. The Company acquired $10.4 million of goodwill in conjunction with the acquisition of Ski West, Inc.

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

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

Restatement

As discussed in Note 2 to the financial statements, the financial statements and related notes thereto contained in the Company s Quarterly Report on Form 10-Q for the three month period September 30, 2005 and the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004 have been restated. This document should be read in conjunction with the Management s Discussion and Analysis section of Amendment No. 1 to our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004. All amounts in the Management s Discussion and Analysis of Financial Condition and Results of Operations have been adjusted, as appropriate, for the effects of this restatement.

Executive Commentary

The following executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business. This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire Management s Discussion and Analysis of Financial Condition and Results of Operation, as well as our audited financial statements included in our Annual Report on Form 10-K/A for the year ended December 31, 2004 and our unaudited financial statements included in this Quarterly Report on Form 10-Q/A as well as the discussion of our business and risk factors and other information included elsewhere in this Form 10-Q/A. This executive commentary includes forward-looking statements, and investors are cautioned to read the Special Note Regarding Forward-Looking Statements included in this Form 10-Q/A.

Commentary: ERP systems upgrade. During the quarter, we went live with a large systems upgrade. We anticipated that as part of the implantation, a small number of background processes would fail, but we experienced more issues than expected. As a result, we put our focus on resolving customer-facing issues (processing orders, shipping products and handling returns) versus internal issues. However, one internal issue was that we were unable to put new products on our site for a five-week period during the quarter, which gradually reduced the number of products on site, resulting in lower site conversion and sales. Once we were able to upload new products in mid-September, sales and site conversion moved back to previous levels.

In addition, other IT projects that were supposed to lift margins through improved efficiencies in logistics or customer service were either late or remain incomplete because the work required to address the ERP implementation eventually monopolized development resources. Other projects such as personalization of the website (Project Propeller) that were supposed to yield marketing gains also went unfinished. Our focus will continue to be the new ERP system through the end of 2005, but we anticipate having the resources necessary to address these additional projects during 2006.

Commentary Growth in Revenue. Total revenue was $169.3 million for the three-month period ended September 30, 2005, a 63.7% increase from the $103.4 million recorded during the same period in 2004. For the nine-month period ended September 30, 2005, total revenue grew 77.8% to $485.8 million from $273.3 million recorded in the same period in 2004.

Commentary Improved Gross Margins and Growth in Gross Profits. Gross margins increased from 13.4% in the third quarter of 2004 to 15.7% during the third quarter of 2005. For the nine-month periods ended September 30, 2004 and 2005, margins improved from 11.8% to 15.2%, respectively.

The improvements in gross margins are a result of the progress we achieved and efficiencies gained in several areas over the last six quarters. In particular, we believe our buying has become more effective as we continue to grow, allowing us to make larger inventory purchases and obtain more favorable pricing. Our total cost per package shipped has decreased due to better process management and lower packaging costs, and as a result of increased sales volumes. As a result of increased volumes and improved vendor relationships, we have obtained decreases in outbound shipping costs. Additionally, we have also made improvements to the cost of processing returns, customer service costs and credit card fees. Management continues to believe that additional improvements can be made in shopping gross margins; in particular as a result of technology projects currently being implemented. In addition, gross margins will increase as the auctions and travel businesses grow, as revenues are recorded net and therefore have much higher gross margins than the traditional shopping business.

Commentary Marketing. Sales and marketing expenses totaled $9.4 million and $17.9 million for the quarters ended September 30, 2004 and 2005, respectively, representing an increase of 91.5%. For those respective three-month periods sales and marketing expenses equaled 9.1% and 10.6% of total revenue. For the nine months ended September 30, 2004 and 2005, sales and marketing expenses increased 141.8%, from $20.4 million to $49.3 million, respectively. As a percentage of total revenue, sales and marketing expenses represent 7.5% and 10.1% for the nine months ended September 30, 2004 and 2005, respectively.

Management believes that our extensive marketing efforts directly resulted in a continued rapid growth in Website traffic (49% year over year for the third quarter, according to Nielsen Net Ratings). However, some of the increase has been in lower-converting traffic as well as traffic to our auctions and travel tabs. Additionally, as a result of a systems implementation that occurred during the third quarter, we were unable to load new products onto the website for five weeks. We believe this had a negative effect on overall site conversion, and therefore our marketing spend was less effective in the third quarter than we had expected. However, once we were able to get new products onto the site during the last two weeks of the quarter, we saw site conversion move back to previous levels.

Commentary Technology expenses . Technology costs increased 252.2%, from $2.3 million in the third quarter of 2004 to $8.1 million in third quarter of 2005. For the nine months ended September 30, 2004 and 2005, technology costs increased 234.1%, from $5.5 million to $18.3 million, respectively.

We have incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for the next growth period of our lifecycle. The increase in absolute dollars was primarily attributable to the increase in hardware, software and personnel costs, and depreciation associated with the new infrastructure, including expansion of corporate systems, including a database site license and the related reimplementation and development of our overall system architecture. The increase in technology expenses also included the costs associated with the strategic projects of 2005, namely the development of an enterprise data warehouse and customer analytics system, completion of our auctions tab, reconstruction of our travel website, and development of our search engine and keyword management application.

As we have done throughout the current year, we intend to continue investing in technology; however, we do not expect the similar stair-step increases in technology expense seen in 2005 to continue, and we expect overall capital expenditures to decrease as a percentage of sales in the near future. However, we will continue to invest in additional functionality for our newly expanded infrastructure.

Commentary General and Administrative Expenses. General and administrative expenses increased 96% from $5.1 million in the third quarter of 2004 to $10.0 million during the third quarter of 2005, representing 4.9% and 5.9% of total revenue, respectively. General and administrative expenses increased 81.1% from $13.7 million during the nine month period ending September 30, 2004 to $24.9 million in the same period ended September 30, 2005, representing 5.0% and 5.1% of total revenue for each of those respective periods.

The increase in general and administrative expenses in the third quarter of 2005 and for the three quarters ended September 30, 2005 relate to the increase in payroll and related expenses and professional fees, primarily in merchandising and finance. In the third quarter of 2005, we relocated our corporate offices to larger facilities to allow for future growth. As a result we expect an additional rent expense of approximately $1 million quarterly.

On July 1, 2005, we completed our acquisition of Ski West and consolidated its operations into our travel business at that time. Ski West s operations contributed an additional $1.6 million of general and administrative expenses and an additional $700,000 of expense related to the amortization of the purchase price to intangible assets.

Critical Accounting Policies and Estimates

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

revenue recognition;

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

accounting for income taxes

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

derivative instruments

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

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

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

Accounting for merchant and agency revenues for our Travel subsidiary

The determination of gross versus net presentation is based principally on the company s consideration of Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements and Emerging Issues Task Force Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, including the weighing of the relevant qualitative factors regarding the company s status as the primary obligor, and the extent of pricing latitude and inventory risk. The method of merchant revenue presentation by the Company does not impact operating profit, net income, or cash flows, but rather revenues and cost of sales.

The principle factor in determining gross versus net presentation was the consideration of who is the primary obligor in the relationship with the customer. Our Travel business provides extensive customer service and support for its customers; however, the supplier hotel is principally liable to its merchant hotel customers in all situations where the customer does not receive the hotel services booked through OTravel.com. In this case, OTravel.com provides customer service support to help resolve issues, even though such customer support could typically involve issues for which OTravel.com is not principally liable.

OTravel.com generates both merchant hotel revenues and agency air, hotel, car and cruise revenues. Merchant hotel revenues are recognized as net revenue at the time of booking since all transactions are billed directly to customers, are nonrefundable and generally non-cancelable, and require no significant post-delivery obligations for OTravel.com. A reserve for charge-backs and cancellations is recorded at the time of the transaction based on historical experience.

Agency revenues are derived from airline ticket transactions, certain hotel transactions as well as cruise and car rental reservations. Agency revenues are recognized on a net basis on air transactions when the reservation is made and secured by a credit card. A cancellation allowance is recognized on these revenues based on historical experience. OTravel.com recognizes agency revenues on hotel reservations, cruise and car rental reservations, either on an accrual basis for payments from a commission clearinghouse or on receipt of commissions from an individual supplier.

Reserve for returns, allowance for doubtful accounts and the allowance for obsolete and damaged inventory. Our management must make estimates of potential future product returns related to current period revenue. Management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns reserve and other allowances in any accounting period. The reserve for returns was $2.8 million and $1.7 million as of December 31, 2004 and September 30, 2005, respectively.

From time to time, we may grant credit to certain of our business customers on normal credit terms. We perform ongoing credit evaluations of our customers financial condition and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectibility of all accounts receivable. We maintained an allowance for doubtful accounts receivable of $750,000 and $1.1 million as of December 31, 2004 and September 30, 2005, respectively.

We write down our inventory for estimated obsolescence or damage equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. Our inventory balance was $46.6 million, net of allowance for obsolescence or damaged inventory of $1.3 million as of December 31, 2004. At September 30, 2005, our inventory balance was $98.1 million, net of reserve for obsolescence or damaged inventory of $2.1 million.

Accounting for income taxes. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. As of December 31, 2004 and September 30, 2005, we have recorded a full valuation allowance of $27.4 million and $34.6 million, respectively, against our net deferred tax asset balance due to uncertainties related to our deferred tax assets as a result of our history of operating losses. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to change the valuation allowance, which could materially impact our financial position and results of operations.

Valuation of long-lived and intangible assets and goodwill. Under SFAS 142, Goodwill and Other Intangible Assets, goodwill is no longer amortized, but must be tested for impairment at least annually. Other long-lived assets must also be evaluated for impairment when management believes that an asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the asset that may not be reflected in an asset s current carrying value, thereby possibly requiring an impairment charge in the future. There was no impairment of goodwill or long-lived assets during the nine months ended September 30, 2005. Goodwill totaled $2.8 million and $13.2 million as of December 31, 2004 and September 30, 2005. The Company added an additional $10.4 million in conjunction with the acquisition of Ski West, Inc. on July 1, 2005.

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

Results of Operations 2004 compared to 2005

Revenue

Total revenue was $169.3 million for the three-month period ended September 30, 2005, a 63.7% increase from the $103.4 million recorded in the same period in 2004. During this same period, direct revenue increased from $43.9 million to $68.4 million, a 55.8% growth. Fulfillment partner revenue grew 69.5%, from $59.5 million in the third quarter of 2004 to $100.9 million in 2005. For the nine-month periods, total revenue grew 77.8% from $273.3 million in 2004 to $485.8 million recorded in 2005. During the same nine-month periods, direct revenue grew 58.9% from $123.6 million to $196.4 million in 2005 and fulfillment revenue grew 93.4% from $149.7 million to $289.4 million.

Gross bookings totaled $114.4 million and $179.5 million for the quarters ended September 30, 2004 and 2005, respectively, representing an increase of 56.9%. For the nine-month periods ended September 30, 2004 and 2005, gross bookings totaled $304.4 million and $527.5 million, respectively, representing an increase of 73.3%. Gross bookings differ from GAAP revenue in that gross bookings represent the gross sales price of goods sold (excluding auctions and travel) by the Company before returns and sales discounts.

Our total revenue for the three and nine month periods ended September 30, 2005, increased as a result of our normal online marketing efforts as well as offline efforts through channels such as nation-wide television, print and radio advertising campaigns. In addition, total revenue benefited from extended discounted shipping promotions run during the months of March, May and six weeks of the third quarter of 2005. Although we experienced overall revenue growth, the rate of growth slowed due to decreased conversion rates during the last half of the quarter. We believe this was primarily the result of a five-week delay in adding new products to the site as a result of an upgrade to our information systems during the quarter

The increase in total revenue is also a reflection of our ability to acquire new customers from our marketing efforts, as evidenced by the addition of 703,000 new customers during the third quarter of 2005 compared to 514,000 new customers in the same quarter of 2004, an increase of 36.8%.

Gross Margins

Total Gross Margins - Cost of goods sold increased 59.3% in absolute dollars from $89.6 million during the third quarter of 2004 to $142.8 million during the same quarter of 2005. In comparing the third quarters of 2004 and 2005, total revenue increased 63.7%, from $103.4 million to $169.3 million, while gross profit dollars increased 91.8%, from $13.9 million to $26.6 million in those same periods. As a percent of total revenue, cost of goods sold decreased from 86.6% to 84.3% for those respective periods resulting in gross margins of 13.4% and 15.7% for the three months ended September 30, 2004 and 2005, respectively.

For the nine-month periods ended September 30, 2004 and 2005, cost of goods totaled $241.0 million and $411.8 million, respectively, representing an improvement in margins from 11.8% to 15.2%, respectively. In dollar terms, gross margins totaled $32.3 million and $74.0 million for the nine months ended September 30, 2004 and 2005, respectively, a 129.1% increase.

Direct Gross Margins - Gross profits for our direct business increased 41.1% from $5.4 million for the quarter ended September 30, 2004 to $9.3 million recorded during the same period in 2005. Direct revenue increased 55.8% from $43.9 million in the quarter ended September 30, 2004 to $68.4 million in the same quarter ended September 30, 2005. Gross profits as a percentage of direct revenue were 12.4% and 13.6% for the third quarters ended September 30, 2004 and 2005, respectively.

For the nine months ended September 30, 2004 and 2005, gross profit dollars for our direct business increased 101.1% from $13.6 million to $27.4 million, representing gross margins of 11.1% and 12.8%, respectively. Sales increased 58.9%, from $123.6 million to $196.4 million for those same comparative periods.

The improvements in direct gross margins year over year are a result of the progress and efficiencies gained in several areas. We believe our buying has become more effective as we continue to grow, allowing us to purchase at more favorable product pricing when compared to prior years. In addition, we have made improvements to our fulfillment costs in the current year, including warehouse handling costs and credit card fees.

We experienced a slight decrease in gross margins in the second and third quarters of 2005. Discounted shipping promotions in March and May and during six weeks of the third quarter of 2005 reduced shipping revenue, and we experienced inefficiencies in warehouse operations as a result of the third quarter systems upgrade. These decreases in gross margins were offset by a 50 basis point increase in gross margins from the addition of Ski West to our existing travel operations.

Fulfillment Partner Gross Margins - Our fulfillment partner business generated gross profits of $8.4 million and $17.3 million for the quarters ended September 30, 2004 and 2005, respectively, an increase of 105.5%. Gross profits as a percentage of fulfillment partner revenue increased from 14.1% during the third quarter of 2004 to 17.1% during the same quarter of 2005. For the nine months ended September 30, 2004 and 2005, gross profits increased 149.6% from $18.7 million to $46.6 million, representing gross margins of 12.5% and 16.1%, respectively.

The increase in gross profit dollars for our fulfillment partner operations was due to the general growth of the consumer business during the year, and an increase in the number of fulfillment partner products offered on our Websites. The increase in gross margins is largely due to improvements in product costs and credit card fees, as well as a decrease in BMV gross bookings from 11.5% of total fulfillment partner bookings during the first three quarters of 2004, to 10.0% during the first three quarters of 2005.

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

Travel Gross Margins - Gross profit dollars for the travel operations were $1.2 million for the quarter ended September 30, 2005. The gross profit dollars generated by the travel business this quarter are primarily a result of merchant hotel revenue related to the operations of Ski West, which we acquired on July 1, 2005. Since revenues from these sales are recorded on a net basis, they result in lower revenue but higher gross margins (81% in the third quarter). If travel sales continue to increase, the higher gross margins will positively impact future gross margins for the overall business.

Fulfillment

Fulfillment costs during the third quarters of 2004 and 2005 were $7.7 million and $13.3 million, respectively, or 7.4% and 7.8% of total revenue for those respective periods. For the nine months ended September 30, 2004 and 2005, fulfillment costs were $20.9 million and $36.1 million, respectively, representing 7.6% and 7.4% of total revenue for those respective periods. Fulfillment costs include warehousing (excluding packaging costs), customer service costs and credit card fees.

Fulfillment costs as a percentage of sales may vary due to several factors, such as our level of productivity and accuracy, changes of units received and fulfilled, the extent we utilize third party fulfillment services and warehouses, and our ability to reduce customer service contacts per transaction by implementing improvements in our operations and customer service.

	Three months ended September 30, 2004		Three months ended September 30, 2005		Nine months ended September 30, 2004		Nine months ended September 30, 2005
Total revenue	$	103,444	$	169,323	$	273,314	$	485,842
Cost of goods sold:								
Product costs, freight costs and other cost of good sold		81,927		129,469		220,113		375,691
Fulfillment costs		7,667		13,290		20,892		36,122
Total cost of goods sold		89,594		142,759		241,005		411,813
Gross profit	$	13,850	$	26,564	$	32,309	$	74,029

Operating expenses

Sales and marketing. Sales and marketing expenses totaled $9.4 million and $18.0 million for the quarters ended September 30, 2004 and 2005, respectively, representing an increase of 91.5%. For the three month periods ended September 30, 2004 and 2005, sales and marketing expenses equaled 9.1% and 10.6%, respectively, of quarterly total revenue. For the nine months ended September 30, 2004 and 2005, sales and marketing expenses increased 141.8%, from $20.4 million to $49.3 million, respectively. As a percentage of total revenue, sales and marketing expenses represent 7.5% and 10.1% for the nine months ended September 30, 2004 and 2005, respectively.

We direct customers to our websites primarily through a number of targeted online marketing channels, such as sponsored search, portal advertising, e-mail campaigns, and other initiatives. We also utilize channels such as nation-wide television, print and radio advertising campaigns. Our marketing expense is variable and is measured as a percentage of overall sales.

Overall online marketing spend has increased in absolute terms in the third quarter of 2005 and the three quarters ended September 30, 2005 compared to prior periods as a result of increased online marketing rates during 2004 and 2005, and an increase in our ongoing online marketing efforts, particularly with the large portals (MSN, Yahoo & AOL), and keyword search (Google). In addition, we continued our television, print and radio campaigns through the third quarter of 2005. Our marketing costs have also increased as a percentage of sales due to marketing efforts in our auctions and travel businesses. Since we record revenues in these businesses on a net basis, they typically have higher marketing expenses as a percent of revenue. These businesses currently account for 100 basis points of total marketing costs as a percent of sales.

While costs associated with our discounted shipping promotions are not included in marketing expense, we consider discounted shipping promotions as an effective marketing tool, and intend to continue to offer them as we deem appropriate.

Technology expenses. Technology expenses increased 256.3%, from $2.3 million in the third quarter of 2004 to $8.1 million in the third quarter of 2005. For the nine months ended September 30, 2004 and 2005, technology costs increased 234.1%, from $5.5 million to $18.3 million respectively.

We have incurred a stair-step increase in technology costs during 2005 in an effort to prepare us for the next growth period of our lifecycle. The increase in absolute dollars was primarily attributable to the increase in hardware, software and personnel costs, and depreciation associated with the new infrastructure, including expansion of corporate systems, such as a database site license and the related reimplementation and development of our overall system architecture. The increase in technology expenses also included the costs associated with the strategic projects of 2005, namely the development of an enterprise data warehouse and customer analytics system, completion of our auctions tab, reconstruction of our travel website, and development of our search engine and keyword management application.

As we have done throughout the current year, we intend to continue investing in technology; however, we do not expect the stair-step increases in technology expense seen in 2005, and we expect overall capital expenditures to decrease as a percentage of sales in the near future. However, we will continue to invest in additional functionality for our newly expanded infrastructure.

General and administrative expenses. General and administrative expenses increased 95.6% from $5.1 million in the third quarter of 2004 to $10.0 million during the third quarter of 2005, representing 4.9% and 5.9% of total revenue, respectively. For the nine-month periods, general and administrative expenses increased 81.1% from $13.7 million in 2004 to $24.9 million in 2005, representing 5.0% and 5.1% of total revenue for those respective periods.

The increase in general and administrative expenses in the third quarter of 2005 and for the three quarters ended September 30, 2005 relate to the increase in payroll and related expenses and professional fees, primarily in merchandising and finance. In the third quarter of 2005, we relocated our corporate offices to larger facilities to allow for future growth. As a result we expect an additional rent expense of approximately $1.0 million quarterly.

On July 1, 2005, we completed our acquisition of Ski West (and renamed it OTravel.com, Inc.) and consolidated its operations into our travel business. Ski West s operations contributed an additional $1.6 million of general and administrative expenses and an additional $700,000 of expense related to the amortization of intangible assets.

Amortization of stock-based compensation. Prior to the Company s initial public offering in May 2002, the Company recorded unearned stock-based compensation related to stock options granted below the fair market value of the underlying stock. Since the initial public offering, the Company has not granted any additional stock options below fair market value. Amortization of stock-based compensation was approximately $18,000 for the three months ended September 30, 2005 and a reversal of $8,000 for the same period in 2005. The reversal was a result of forfeitures of unvested options for which compensation expenses had been previously recorded. For the nine months ended September 30, 2004 and 2005, amortization of stock-based compensation totaled $276,000 and $65,000, respectively.

Non-operating income (expense)

Interest income, interest expense and other income (expense).

The primary component of our net interest income (expense) relates to the interest derived from the investment of our excess cash in marketable securities offset by interest expense related to the convertible debt, letters of credit, capital leases, and other related fees. Additionally, we incurred a large expense during the quarter related to the valuation of the conditional coupon of our foreign bonds. Interest income and other decreased from $168,000 in the third quarter of 2004 to $1.7 million negative interest income in the third quarter of 2005. For the nine months ended September 30, 2004 interest income (expense) decreased from $393,000 of interest income to negative interest income of $150,000 because of the valuation of our foreign bonds. For the quarter ended September 30, 2005 the valuation of the conditional coupon of our foreign bonds resulted in a loss of $2.1 million, and a loss of approximately $2.4 million for the nine months ended September 30, 2005. See Item 1 of Part 1, Financial Statements Note 4 Marketable Securities .

Interest expense is comprised largely of interest expense related to our convertible notes, capital leases and our line of credit. Interest expense increased from $77,000 during the third quarter of 2004 to $1.3 million during the third quarter of 2005, primarily as a result of the interest expense from our convertible senior notes issued in November 2004. For the nine months ended September 30, 2004 and 2005, interest expense totaled $139,000 and $4.2 million, respectively.

We recorded other income, net of $3,000 and $11,000 during the third quarters of 2004 and 2005, respectively. For the nine months ended September 30, 2004 and 2005, other income totaled $5,000 and $4.2 million, respectively. The $4.2 million gain incurred in the nine months ended September 30, 2005 relates the retirement of $33.0 million of the 3.75% Convertible Senior Notes which occurred during the second quarter of 2005. See Item 1 of Part 1, Financial Statements Note 13 3.75% Convertible Senior Notes .

Income taxes

Income taxes. For the three and nine months ended September 30, 2004 and 2005, we incurred net operating losses, and consequently paid insignificant amounts of federal, state and foreign income taxes. As of December 31, 2004 and September 30, 2005, we had $73.1 million and $91.3 million, respectively, of net operating loss carryforwards, of which $21.9 million is subject to limitation. These net operating loss carryforwards will begin to expire in 2019.

Recent Accounting Pronouncements

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

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

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

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

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

Seasonality

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

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005	$ 165,881	$ 150,638	$ 169,323	
2004	82,078	87,792	103,444	$ 221,321
2003	29,164	28,833	57,788*	123,160
2002	12,067	14,380	23,808	41,529

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

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Liquidity and Capital Resources

Prior to the third quarter of 2002, we financed our activities primarily through a series of private sales of equity securities, warrants to purchase our common stock and promissory notes. During the second quarter of 2002, we completed our initial public offering pursuant to which we received approximately $26.1 million in cash, net of underwriting discounts, commissions, and other related expenses. Additionally, we completed follow-on offerings in February 2003, May 2004 and November 2004, pursuant to which we received approximately $24.0 million, $37.9 million and $75.2 million, respectively, in cash, net of underwriting discounts, commissions, and other related costs. In November 2004, we also received $116.2 million in proceeds from the issuance of our convertible senior notes. At September 30, 2005, our cash and cash equivalents balance was $2.6 million and our marketable securities totaled $74.2 million.

Our operating activities resulted in cash outflows of $927,000 and $19.9 million for the quarters ended September 30, 2004 and 2005, respectively. For the nine months ended September 30, 2004 and 2005, operating activities resulted in cash outflows of $12.4 million and $65.2 million, respectively. The primary operating uses of cash and cash equivalents during the first nine months of 2005 was to fund our operations, including net losses of $18.6 million, increases in inventory of $51.6 million as we prepare for the fourth quarter holiday sales season, prepaid expenses of $5.8 million and the change in accounts payable of $17.9 million. This was offset by the change in accounts receivable and accrued liabilities of $7.0 million and $22.0 million, respectively.

Cash used in investing activities totaled $31.3 million and $47.4 million for the nine months ended September 30, 2004 and 2005, respectively. The cash outflow for investing activities was attributed to capital expenditures for property and equipment of $36.5 million and the acquisition of Ski West, Inc. for $24.6 million. Cash flows used in investing activities was offset by a net increase of $12.7 million from the purchases and sales of marketable securities.

Our financing activities resulted in net cash inflows of $41.9 million during the nine months ended September 30, 2004 and net cash outflows of $83.6 million for the same period in 2005. The cash outflows for financing activities for 2005 were due to $3.2 million in capital lease obligations, purchased call options totaling $47.5 million, payments on early extinguishment of debt of $27.9 million and purchase of treasury stock of $24.1 million. During that same period, we received proceeds from the exercise of stock options and warrants of $6.9 million and borrowed $4.4 million from our line of credit.

Contractual Obligations and Commitments

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

	Payments Due by Period (in thousands)				
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 years**
Long-term debt arrangements	$ 87,000	$	$	$	$ 87,000
Interest on convertible senior notes	21,469	1,894	6,525	6,525	6,525
Capital lease obligations	14,832	7,202	7,630		
Operating leases	72,796	5,488	13,749	15,407	38,152
Purchase obligations	52,500	52,500			
Total contractual cash obligations	$ 248,597	$ 67,084	$ 27,904	$ 21,932	$ 131,677

		Amounts of Commitment Expiration Per Period (in thousands)			
Other Commercial Commitments	**Total Amounts Committed**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**Over 5 years**
Letters of credit	$ 6,918	$ 6,918	$	$	$
Redeemable common stock	3,306		3,306		
Total commercial commitments	$ 10,224	$ 6,918	$ 3,306	$	$

In November 2004, we completed an offering of $120.0 million of 3.75% Convertible Senior Notes (the Senior Notes). Interest on the Senior Notes is payable semi-annually on June 1 and December 1 of each year, beginning June 1, 2005. The Senior Notes mature on December 1, 2011 and are unsecured and rank equally in right of payment with all existing and future unsecured, unsubordinated debt and senior in right of payment to any existing and future subordinated indebtedness. The Senior Notes are convertible at any time prior to maturity into our common stock at the option of the note holders at a conversion price of $76.23 per share (subject to adjustment in certain events, including stock splits, dividends and other distributions and certain repurchases of our stock, as well as certain fundamental changes in the ownership of the Company).

Beginning December 1, 2009, we have the right to redeem the Senior Notes, in whole or in part, for cash at 100% of the principal amount plus accrued and unpaid interest. Upon the occurrence of a fundamental change (including the acquisition of a majority interest in the Company, certain changes in the Company s board of directors or the termination of trading of our stock) meeting certain conditions, holders of the Senior Notes may require us to repurchase for cash all or part of their notes at 100% of the principal amount plus accrued and unpaid interest.

In June 2005, under the Share Buyback Program (Note 11), the Company retired $33.0 million of 3.75% Convertible Senior Notes (the Senior Notes), which were due on December 1, 2011 for $27.9 million in cash. Interest on the notes was payable on June 1 and December 1 of each year. As a result of the note retirement, we recognized a gain of $4.2 million, net of the associated unamortized discount of $960,000. As of September 30, 2005, $87.0 million of Senior Notes remain outstanding.

The lease obligations include our obligations under a ten-year lease agreement we entered in December 2004 for approximately 143,000 square feet of office space in Salt Lake City. We took possession of the new office space in July of 2005, and terminated our lease obligations under our previous office lease agreements at the same time. The total lease obligation over the ten-year term of the new lease is $39.6 million, of which approximately $1.9 million will be payable in 2005. In connection with the preparation of the new office space, we have agreed to provide a letter of credit for $500,000 to provide funds for the removal of the improvements upon termination of the new sublease and have also agreed to pay approximately $2.0 million for leasehold improvements. We expect to pay this entire amount for leasehold improvements during 2005.

The amount of purchase obligations shown is based on assumptions regarding the legal enforceability against us of purchase orders we had outstanding at September 30, 2005. 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.

In December 2004, we replaced our senior secured credit facility by amending a facility we had with Wells Fargo Bank, National Association. On October 18, 2005 we entered into a Sixth Amendment (the Sixth Amendment) which increased the aggregate amount available under the credit facility from $20 million to $30 million. The Sixth Amendment also eliminated the requirement that the Company maintain specified cash balances with Wells Fargo as a condition to the availability of advances under the facility, and substituted collateral consisting of foreign bond securities owned by the Company in an aggregate principal amount of $50.0 million to secure the Company s obligations under the facility. The Sixth Amendment includes a $15.0 million sub-limit which we use to obtain letters of credit to support inventory purchases. At September 30, 2005 the issuing bank or an affiliate of the bank had letters of credit totaling $6.9 million issued on our behalf under this facility. We have an option to renew the Amended Credit Agreement annually. The Sixth Amendment increased the interest rate on fixed rate advances under the credit facility to 1.35% above LIBOR on the first day of each fixed rate term under the credit facility the interest rate.

The agreement governing the facility requires us to comply with certain covenants, including restrictions on mergers, business combinations or transfers of assets. We were in compliance with these covenants at September 30, 2005. At September 30, 2005, $4.4 million was outstanding under the facility and $6.9 million in letters of credit was outstanding.

The estimated amount of redeemable common stock is based solely on the statutes of limitations of the various states in which stockholders may have rescission rights and may not reflect the actual results. The stock is not redeemable by its terms. We do not have any unconditional purchase obligations, other long-term obligations, guarantees, standby repurchase obligations or other commercial commitments.

In January 2005, the Company s Board of Directors authorized a stock buyback program under which we may repurchase up to $50.0 million of our common stock through December 31, 2007. In April 2005, the Company s Board of Directors authorized an increase to the stock buyback program from $50.0 million to a total of $100.0 million. Additionally, on June 14, 2005, the Board of Directors amended the stock repurchase program to authorize the repurchase of our Convertible Senior Notes.

Under the buyback program, we repurchased approximately 665,000 shares of our common stock in open market transactions for $24.1 million during the nine months ended September 30, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $41.1 million of structured stock repurchase transactions during the nine months ended September 30, 2005. The structured stock repurchase transactions not settled in stock were settled in cash totaling $7.9 million which we received in July 2005. These transactions are recorded in shareholder s equity in the accompanying consolidated balance sheets.

We believe that the cash and marketable securities 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. While we anticipate that, beyond the next twelve months, our expected cash flows from future operations will be sufficient to fund our operational requirements, we may require additional financing. However, 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, generate profitability or raise additional capital could have a material adverse effect on our ability to continue as a going concern and to achieve our intended business objectives. Any projections

of future cash needs and cash flows are subject to substantial uncertainty. See Factors that May Affect Future Results.

Government Regulation

All of our services are subject to federal and state consumer protection laws including laws protecting the privacy of consumer non-public 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, must provide advance notice of any changes to our policies and, with limited exceptions, 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 and could interfere with the conduct of our business.

In January 2005, we received an initial inquiry from the Federal Trade Commission (FTC) regarding our shipping policies, procedures, and practices and other matters. We responded to the initial inquiry, and we continue to cooperate with the FTC in providing additional information the FTC has requested in follow-up inquiries. We are currently unable to determine the potential outcome of this inquiry.

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 tax regulations may subject us to additional state sales and income taxes. 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 below, and all other information in this Form 10-Q/A and in our other filings with the SEC including those we file after we file this Form 10-Q/A, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the following risks 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.

Risks Relating to Overstock

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

We have a history of losses and we may continue to incur operating and net losses for the foreseeable future. We incurred net losses attributable to common shares of $2.9 million and $12.4 million for the quarters ended September 30, 2004 and 2005, respectively. As of December 31, 2004, and September 30, 2005, our accumulated deficit was $71.7 million and $90.5 million, respectively. We will need to generate significant revenues to achieve profitability, and we may not be able to do so. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If our revenues grow more slowly than we anticipate, or if our operating expenses exceed our expectations, our financial results would be harmed.

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

- enhance our distribution and order fulfillment capabilities;
- further improve our order processing systems and capabilities;
- develop enhanced technologies and features;
- expand our customer service capabilities to better serve our customers needs;
- expand our product offerings, including our auctions site, our travel site and our custom design jewelry site;
- rent additional warehouse and office space;
- increase our general and administrative functions to support our operations; and
- maintain or increase our sales, branding and marketing activities, including maintaining existing or entering into new online marketing arrangements, and continuing or increasing our national television and radio branding campaigns.

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

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

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

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

During the third quarter of 2005, we had fulfillment partner relationships with approximately 419 third parties whose products we offer for sale on our Websites. At September 30, 2005, these products accounted for approximately 75% of the non-BMV products available on our Websites. We do not have any long-term agreements with any of these third parties. Our agreements with third parties are terminable at will by either party immediately upon notice. In general, we agree to offer the third parties products on our Websites and these third parties agree to provide us with information about their products, honor our customer service policies and ship the products directly to the customer. If we do not maintain our existing or build new relationships with third parties on acceptable commercial terms, we may not be able to offer a broad selection of merchandise, and customers may refuse to shop at our Websites. In addition, manufacturers may decide not to offer particular products for sale on the Internet. If we are unable to maintain our existing or build new fulfillment partner relationships or if other product manufacturers refuse to allow their products to be sold via the Internet, our business and prospects would suffer severely.

We are partially dependent on third parties to fulfill a number of our fulfillment, distribution and other retail functions. If such parties are unwilling or unable to continue providing these services, our business could be seriously harmed.

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

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

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

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

We rely upon multiple third parties for the shipment of our products. Because we do not have a written long-term agreement with any of these third parties, we cannot be sure that these relationships will continue on terms favorable to us, if at all. Unexpected increases in shipping costs or delivery times, particularly during the holiday season, could harm our business, prospects, financial condition and results of operations. If our relationships with these third parties are terminated or impaired or if these third parties are unable to deliver products for us, whether through labor shortage, slow down or stoppage, deteriorating financial or business condition, responses to terrorist attacks or for any other reason, we would be required to use alternative carriers for the shipment of products to our customers. In addition, conditions such as adverse weather can prevent any carriers from performing their delivery services, which can have an

adverse effect on our customers satisfaction with us. In any of these circumstances, we may be unable to engage alternative carriers on a timely basis, upon terms favorable to us, or at all. Changing carriers would likely have a negative effect on our business, prospects, operating results and financial condition. Potential adverse consequences include:

- reduced visibility of order status and package tracking;
- delays in order processing and product delivery;
- increased cost of delivery, resulting in reduced gross margins; and
- reduced shipment quality, which may result in damaged products and customer dissatisfaction.

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

We allow our customers to return products and, beginning July 1, 2003, we started accepting returns of products sold through our fulfillment partners. We modify our policies relating to returns from time to time, and any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer return customers. If merchandise returns are significant, our business, prospects, financial condition and results of operations could be harmed.

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

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

We face risks relating to our inventory.

We directly purchase some of the merchandise that we sell on our Websites. We assume the inventory damage, theft and obsolescence risks, as well as price erosion risks for products that we purchase directly. These risks are especially significant because some of the merchandise we sell on our Websites are characterized by rapid technological change, obsolescence and price erosion (for example, computer hardware, software and consumer electronics), and because we sometimes make large purchases of particular types of inventory. In addition, we often do not receive warranties on the merchandise we purchase. Further, beginning July 1, 2003, we started accepting returns of products sold through our fulfillment partners, and we have the risk of reselling the returned products.

In the recent past, we have recorded charges for obsolete inventory and have had to sell certain merchandise at a discount or loss. It is impossible to determine with certainty whether an item will sell for more than the price we pay for it. Because we rely heavily on purchased inventory, our success will depend on our ability to liquidate our inventory rapidly, the ability of our buying staff to purchase inventory at attractive prices relative to its resale value and our ability to manage customer returns and the shrinkage resulting from theft, loss and misrecording of inventory. If we are unsuccessful in any of these areas, we may be forced to sell our inventory at a discount or loss.

We have grown quickly and if we fail to manage our growth, our business will suffer.

We have rapidly and significantly expanded our operations, and anticipate that further significant expansion will be required to address potential growth in our customer base and market opportunities. This expansion has placed, and is expected to continue to place, a significant strain on our management, operational and financial resources. Some of our officers have no prior senior management experience at public companies. Our new employees include a number of key managerial, technical and operations personnel, and we expect to add additional key personnel in the future. To manage the expected growth of our operations and personnel, we will be required to improve existing and implement new transaction-processing, operational and financial systems, procedures and controls, and to expand, train and manage our already growing employee base. If we are unable to manage growth effectively, our business, prospects, financial condition and results of operations will be harmed.

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

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel, particularly Patrick M. Byrne, our President. Our performance also depends on our ability to retain and motivate other officers and key employees. The loss of the services of any of our executive officers or other key employees for any unforeseen reason, including without limitation, illness or call to military service, could harm our business, prospects, financial condition and results of operations. We do not have employment agreements with any of our key personnel and we do not maintain key person life insurance policies. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense, and we cannot assure you that we will be able to successfully attract, assimilate or retain sufficiently qualified personnel. Our failure to retain and attract the necessary technical, managerial, editorial, merchandising, marketing and customer service personnel could harm our revenues, business, prospects, financial condition and results of operations.

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

Our long-term strategic plan involves expansion of our operations to offer additional types of products and services. We cannot assure you that our efforts to expand our business in this manner will succeed. Because we were unable to generate significant traffic for our former B2B site, in the third quarter of 2004, we merged the B2B site into our main website, and opened our Club O Gold bulk purchase program. Our failure to succeed in this market or other markets or other product or service offerings may harm our business, prospects, financial condition and results of operation. We cannot assure you that we will be able to expand our operations in a cost-effective or timely manner or that our efforts to expand will be successful. Furthermore, any new business or Website we launch that is not favorably received by consumers could damage our reputation or the Overstock.com brand. We may expand the number of categories of products we carry on our Websites, and these and any other expansions of our operations would also require significant additional expenses and development and would strain our management, financial and operational resources. The lack of market acceptance of such efforts or our inability to generate satisfactory revenues from such expanded services or products to offset their cost could harm our business, prospects, financial condition and results of operations.

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

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

the need to develop new supplier and manufacturer relationships;

- the need to comply with additional laws and regulations to the extent applicable;
- unexpected changes in international regulatory requirements and tariffs;
- difficulties in staffing and managing foreign operations;
- longer payment cycles from credit card companies;
- greater difficulty in accounts receivable collection;
- potential adverse tax consequences;
- price controls or other restrictions on foreign currency; and
- difficulties in obtaining export and import licenses.

To the extent we generate international sales and transactions in the future, any negative impact on our international operations could negatively impact our business. In particular, gains and losses on the conversion of foreign payments into United States dollars may contribute to fluctuations in our results of operations and fluctuating exchange rates could cause reduced gross revenues and/or gross margins from non-dollar-denominated international sales.

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

Our success depends on our ability to attract customers on cost-effective terms. We have relationships with online services, search engines, directories and other Websites and e-commerce businesses to provide content, advertising banners and other links that direct customers to our Websites. We rely on these relationships as significant sources of traffic to our Websites and to generate new customers. If we are unable to develop or maintain these relationships on acceptable terms, our ability to attract new customers and our financial condition could be harmed. In addition, certain of our online marketing agreements may require us to pay upfront fees and make other payments prior to the realization of the sales, if any, associated with those payments. Accordingly, if these agreements or similar agreements that we may enter into in the future fail to produce the sales that we anticipate, our results of operations will be adversely affected. We cannot assure you that we will be able to increase our revenues, if at all, in a cost-effective manner. We periodically conduct national television and radio branding and advertising campaigns. Such campaigns are expensive and may not result in the cost effective acquisition of customers.

Further, many of the parties with which we may have online-advertising arrangements could provide advertising services for other online or traditional retailers and merchandise liquidators. As a result, these parties may be reluctant to enter into or maintain relationships with us. Failure to achieve sufficient traffic or generate sufficient revenue from purchases originating from third parties may result in termination of these relationships by these third parties. Without these relationships, our revenues, business, prospects, financial condition and results of operations could suffer.

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

The online liquidation services market is new, rapidly evolving and intensely competitive. Barriers to entry are minimal, and current and new competitors can launch new Websites at a relatively low cost. Our consumer Website currently competes with:

other online liquidation e-tailers, such as SmartBargains;

traditional retailers and liquidators, such as Ross Stores, Inc., and Walmart Stores, Inc.; and online retailers and marketplaces such as Amazon.com, Inc., Buy.com, Inc. and eBay, Inc., which have discount departments.

Our Website competes with liquidation brokers and retailers and online marketplaces such as eBay, Inc.

We expect the online liquidation services market to become even more competitive as traditional liquidators and online retailers continue to develop services that compete with our services. In addition, manufacturers and retailers may decide to create their own Websites to sell their own excess inventory and the excess inventory of third parties. Competitive pressures created by any one of our competitors, or by our competitors collectively, could harm our business, prospects, financial condition and results of operations.

Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service or marketing decisions or acquisitions that could harm our business, prospects, financial condition and results of operations. For example, to the extent that we enter new lines of businesses such as third-party logistics, or discount brick and mortar retail, we would be competing with large established businesses such as APL Logistics, and Ltd., Ross Stores, Inc., respectively. We have recently entered the online auctions business in which we compete with large established businesses including eBay, Inc.

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

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

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

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

Our transaction processing systems and network infrastructure may be unable to accommodate increases in traffic in the future. We may be unable to project accurately the rate or timing of traffic increases or successfully upgrade our systems and infrastructure to accommodate future traffic levels on our Websites. In addition, we may be unable to upgrade and expand our transaction processing systems in an effective and timely manner or to integrate any newly developed or purchased functionality with our existing systems. For example, in the third quarter 2005 we experienced difficulties with our implementation of infrastructure upgrades, which resulted in our inability to upload new products to our website for a period of approximately five weeks. Any such difficulties with our transaction processing systems or other difficulties upgrading, expanding or integrating various aspects of our systems may cause unanticipated system disruptions, slower response times, degradation in levels of customer service, additional expense, impaired quality and speed of order fulfillment or delays in reporting accurate financial information.

If the facilities where substantially all of our computer and communications hardware is located fail, our business, results of operations and financial condition will be harmed.

Our success, and, in particular, our ability to successfully receive and fulfill orders and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications systems. Substantially all of our computer and communications hardware is located at a single co-location facility in Salt Lake City, Utah, with a partially redundant back-up system located at our corporate headquarters in Salt Lake City. Although we have designed our back-up system in an effort to avoid or minimize service interruptions in the event of a failure of our main facility, our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, acts of war, break-ins, earthquake and similar events. We do not have a formal disaster recovery plan and our business interruption insurance may be insufficient to compensate us for losses that may occur. Despite the implementation of network security measures, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could harm our business, prospects, financial condition and results of operations.

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

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

Our failure to protect our software and other proprietary intellectual property rights or to develop technologies that are as good as our competitors could put us at a disadvantage to our competitors. In addition, the failure of the third parties whose products we offer for sale on our Websites to protect their intellectual property rights, including their domain names, could impair our operations. These failures could harm our business, results of operations and financial condition.

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

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

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

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

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

As we continue to expand internationally, we are subject to risks of doing business internationally as related to our intellectual property, including:

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

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

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

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our Websites infringe third-party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties past, current or future intellectual property rights. For example, in October 2003, Tiffany (NJ) Inc. and Tiffany and Company filed a complaint against us in the United States District Court for the Southern District of New York alleging that we have distributed counterfeit and otherwise unauthorized Tiffany product in violation of federal copyright and trademark law and related state laws. In addition, in January 2005, Tiffany filed additional complaints against us asserting similar claims. See Legal Proceedings for additional information regarding our lawsuits with Tiffany and other third parties.

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

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

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

Gradient Analytics and Rocker Partners, L.P. Litigation

In August 2005 we filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, L.P. and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit. In October 2005 we filed an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. Overstock s President, Dr. Patrick Byrne, has appeared on nationally syndicated television programs and elsewhere to discuss the litigation. The use of management s time and attention in connection with the litigation and related matters may reduce the time management is able to spend on other aspects of our business, which may have adverse effects on other aspects of our business. To the extent that any such adverse effects exceed any benefits we may realize from pursuing the litigation, our business, prospects, financial condition and results of operation may suffer.

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

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

We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of confidential information such as customer credit card numbers. We cannot assure you that advances in computer capabilities, new discoveries in the field of cryptography or other events or developments will not result in a compromise or breach of the algorithms that we use to protect customer transaction data. If any such compromise of our security were to occur, it could harm our reputation, business, prospects, financial condition and results of operations. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. We cannot assure you that our security measures will prevent security breaches or that failure to prevent such security breaches will not harm our business, prospects, financial condition and results of operations.

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

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

We may face risks relating to our recent acquisition of Ski West, Inc. and the development of our travel business.

We acquired all of the capital stock of Ski West, Inc., an on-line travel company, on July 1, 2005. There can be no assurance about the future performance of the Ski West business. We may encounter unforeseen operating or other difficulties. The integration of any acquired business can be difficult, and unforeseen problems can arise. The Ski West business operates on a software platform that is different from the ones we use in the rest of our business, and it may be difficult or expensive for us to achieve any necessary or desirable integration. Although we have operated a travel service in the past, the travel business operated by Ski West is substantially greater than the travel business we operated, and will involve new and potentially unforeseen risks, including exposure to seasonal and other fluctuations in leisure travel, including disruptions resulting from domestic or international terrorist incidents or expectations or perceptions of leisure travelers regarding the safety and desirability of leisure travel.

We may face risks relating to our recent expansion into online wine sales.

We have recently begun limited online sales of wine. Online wine sales are highly regulated and restricted by numerous governmental authorities. Although we currently fulfill all of our wine sales through a licensed distributor, which is responsible for compliance with applicable laws, rules, regulations, and interpretations of relevant authorities, certain regulations relating to the wine sales business affect us directly as well. We expect to incur costs as we develop systems to comply with the applicable regulations, and expect that these regulations will increase our costs of engaging in this business over the costs that we would face in the absence of such regulation.

We have significant indebtedness.

In connection with our sale of our 3.75% Convertible Senior Notes (the Senior Notes) in November 2004, we incurred $120.0 million of indebtedness. In June 2005, under the Share Buyback Program (see Note 11) of the notes to the financial statements), the Company retired $33.0 million of its Senior Notes which were due on December 1, 2011 for $27.9 million in cash. As a result of the note retirement, the Company recognized a net gain of $4.2 million, net of the associated unamortized discount of $960,000. As of September 30, 2005, $87.0 million of the Senior Notes remained outstanding. As a result of this indebtedness, our principal and interest payment obligations increased substantially. The degree to which we will be leveraged could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

We may be unable to generate sufficient cash flow to satisfy our debt service obligations.

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

FTC Inquiry

In January 2005 we received an initial inquiry from the Federal Trade Commission (FTC) regarding our shipping policies, procedures, and practices and other matters. We responded to the initial inquiry, and we continue to cooperate with the FTC in providing additional information the FTC has requested in follow-up inquiries. During 2005 we experienced difficulties with our implementation of our infrastructure upgrades, which in turn caused us additional difficulties with certain of the operational matters covered by the FTC s inquiry. We are unable to determine the potential outcome of the FTC s inquiry.

Risks Relating to our Auctions Site Business

Our auctions site is a new business.

Our auctions site began operation in September 2004. The online auctions business is a new business for us, and we cannot assure you that our expansion into the online auctions business will succeed.

Our entry into the online auctions business will require us to devote substantial financial, technical, managerial and other resources to the business. It will also expose us to additional risks, including legal and regulatory risks, and will require us to compete with established businesses having substantially greater experience in the online auctions business and substantially greater resources than we do.

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

Many states and other jurisdictions, including Utah, where our company is located, have regulations governing the conduct of traditional auctions and the liability of traditional auctioneers in conducting auctions. Although the vast majority of these regulations clearly contemplated only traditional auctions, and did not contemplate online auctions, the potential application of these types of regulations to online auction sites is not clear. We are aware that several states and some foreign jurisdictions have attempted to impose such regulations on other companies operating online auction sites or on the users of those sites. In addition, certain states have laws or regulations that do expressly apply to online auction site services. Although we do not expect these laws to have a significant effect on our auction site business, we will incur costs in complying with these laws, and we may from time to time be required to make changes in our business that may increase our costs, reduce our revenues, cause us to prohibit the listing of certain items in certain locations, or make other changes that may adversely affect our auctions business.

Current and future laws could affect our auctions business.

Like our shopping site business, our auction site business is subject to the same laws and regulations as apply to other companies conducting business on and off the Internet. In addition, our auction site business may be affected by other laws and regulations, such as those that expressly apply to online auction site services. Further, because of the wide range of items that users of our auctions service may choose to list on the site, a variety of additional laws and regulations may apply to transactions between users of our site, such as those requiring a license to sell or purchase certain items or mandating particular disclosures in connection with an offer or sale of an item. To the extent that such current or future laws or regulations prevent users from selling items on our auction site, they could harm our business.

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

The law regarding the potential liability of an online auction service for the activities of its users is not clear. We prohibit the listing of numerous categories of items in an effort to reduce the possibility that users of our auction site will engage in an unlawful transaction. However, we cannot assure that users of the site will comply with all laws and regulations applicable to them and their transactions, and we may be subject to allegations of civil or criminal liability for any unlawful activities conducted by them. Any costs we incur as a result of any such allegations, or as a result of actual or alleged unlawful transactions utilizing our site, or in our efforts to prevent any such transactions, may harm our business. In addition, any negative publicity we receive regarding any such transactions or allegations may damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

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

We are aware that other companies operating online auction services have periodically received complaints from users alleging that they have not received the purchase price or the goods they expected to receive, and that in some cases users have been arrested and convicted for engaging in fraudulent activities using those companies auction sites. We may receive similar complaints. We do not have the ability to require users of our services to fulfill their obligations to make payments or to deliver items. We are aware that other companies periodically receive complaints from buyers about the quality of the items they purchase, requests for reimbursement of amounts paid, and communications threatening or commencing legal actions against them. We may receive similar complaints, requests and communications in connection with our auctions site business.

We are subject to risks associated with information transmitted through our service.

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both U.S. and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. We are aware that private lawsuits seeking to impose liability under a number of these theories have been brought against other companies operating auction sites. In addition, domestic and foreign legislation has been proposed that would prohibit or impose liability for the transmission over the Internet of certain types of information. Our service permits users to make comments regarding other users. Although all such comments are generated by users and not by us, we are aware that claims of defamation or other injury have been made against other companies operating auction services in the past and could be made in the future against us for comments made by users. Recent court decisions have narrowed the scope of the immunity provided to Internet service providers like us under the Communications Decency Act. This trend, if continued, may increase our potential liability to third parties for the user-provided content on our site.

Difficulties or negative publicity associated with our auctions business could affect our main shopping site business.

Any significant operational or other difficulties we encounter with our auctions business could damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally. Negative publicity resulting from actual or alleged fraudulent or deceptive conduct by users of our auctions site could also damage our reputation, our ability to attract new customers to our main shopping site, and the Overstock.com brand name generally.

Risks Relating to the Internet Industry

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

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

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

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

Our long-term future depends heavily upon the general public s willingness to use the Internet as a means to purchase goods. E-commerce remains a relatively new concept, and large numbers of customers may not begin or continue to use the Internet to purchase goods. The demand for and acceptance of products sold over the Internet are highly uncertain, and most e-commerce businesses have a short track record. If consumers are unwilling to use the Internet to conduct business, our business may not develop profitably.

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

In order for the e-commerce market to develop successfully, we and other market participants must be able to transmit confidential information securely over public networks. Third parties may have the technology or know-how to breach the security of customer transaction data. Any breach could cause customers to lose confidence in the security of our Websites and choose not to purchase from our Websites. If someone is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt our operations. Concerns about the security and privacy of transactions over the Internet could inhibit the growth of the Internet and e-commerce. Our security measures may not effectively prohibit others from obtaining improper access to our information. Third parties may target our customers directly with fraudulent identity theft schemes designed to appear as legitimate communications from us. Any security breach or fraud perpetrated on our customers could expose us to increased costs and to risks of loss, litigation and liability and could seriously disrupt our operations.

Credit card fraud could adversely affect our business.

We do not carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce our net revenues and our gross margin. We have implemented technology to help us detect the fraudulent use of credit card information. However, we may in the future suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we do not obtain a cardholder s signature. If we are unable to detect or control credit card fraud, our liability for these transactions could harm our business, results of operation or financial condition.

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

We do not currently collect sales or other similar taxes for physical shipments of goods into states other than Utah or Indiana. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies that engage in online commerce. Our business could be adversely affected if one or more states or any foreign country successfully asserts that we should collect sales or other taxes on the sale of our merchandise.

Existing or future government regulation could harm our business.

We are subject to the same federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards conducting business on the Internet. However, due to the increasing popularity and use of the Internet, many laws and regulations relating to the Internet are being debated at the state and federal levels. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy could also harm our business. For example, United States and foreign laws regulate our ability to use customer information and to develop, buy and sell mailing lists. The vast majority of these laws was adopted prior to the advent of the Internet, and do not contemplate or address the unique issues raised thereby. Those laws that do reference the Internet are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. These current and future laws and regulations could harm our business, results of operation and financial condition.

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

We are subject to increasing regulation at the federal, state and international levels relating to privacy and the use of personal user information. For example, we are subject to various telemarketing laws that regulate the manner in which we may solicit future suppliers and customers. Such regulations, along with increased governmental or private enforcement, may increase the cost of growing our business. In addition, many jurisdictions have laws that limit the uses of personal user information gathered online or offline or require companies to establish privacy policies. The Federal Trade Commission has adopted regulations regarding the collection and use of personal identifying information obtained from children under 13. Proposed legislation in this country and existing laws in foreign countries require companies to establish procedures to notify users of privacy and security policies, obtain consent from users for collection and use of personal information, and/or provide users with the ability to access, correct and delete personal information stored by us. Additional legislation regarding data security and privacy has been proposed in Congress. These data protection regulations may restrict our ability to collect demographic and personal information from users, which could be costly or harm our marketing efforts, and could require us to implement new and potentially costly processes, procedures and/or protective measures.

Risks Relating to the Securities Markets and Ownership of Our Securities

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

Our common stock has been publicly traded only since May 30, 2002. The market price of our common stock has been subject to significant fluctuations since the date of our initial public offering. These fluctuations could continue. It is possible that in some future periods our results of operations may be below the expectations of public market analysts and investors. If this occurs, the market price of our securities may decline. Among the factors that could affect the market price of our securities are as follows:

- changes in securities analysts   recommendations or estimates of our financial performance or publication of research reports by analysts;
- changes in market valuations of similar companies;
- announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, joint ventures or capital commitments;
- general market conditions;
- actual or anticipated fluctuations in our operating results;
- intellectual property or litigation developments;

- changes in our management team;
- economic factors unrelated to our performance; and
- our issuance of additional shares of stock or other securities.

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

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

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

increases in the cost of advertising;

our inability to retain existing customers or encourage repeat purchases;

the extent to which our existing and future marketing agreements are successful;

price competition that results in lower profit margins or losses;

the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;

the amount and timing of our purchases of inventory;

our inability to manage distribution operations or provide adequate levels of customer service;

our ability to successfully integrate operations and technologies from acquisitions or other business combinations;

entering into new lines of products;

our ability to attract users to our new auctions site; and

our inability to replace the loss of significant customers.

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

We have experienced and expect to continue to experience fluctuations in our operating results because of seasonal fluctuations in traditional retail patterns. Sales in the retail and wholesale industry tend to be significantly higher in the fourth calendar quarter of each year than in the preceding three quarters due primarily to increased shopping activity during the holiday season. However, there can be no assurance that our sales in the fourth quarter will exceed those of the preceding quarters or, if the fourth quarter sales do exceed those of the preceding quarters, that we will be able to manage the increased sales effectively. Further, we generally increase our inventories substantially in anticipation of holiday season shopping activity, which has a negative effect on our cash flow. Securities analysts and investors may inaccurately estimate the effects of seasonality on our results of operations in one or more future quarters and, consequently, our operating results may fall below expectations, causing the market price of our securities to decline.

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

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

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

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

Issuances of our securities are subject to federal and state securities laws, and certain holders of common stock issued by us may be entitled to rescind their purchases.

Issuances of securities are subject to federal and state securities laws. From November 1999 through September 2000, we offered and sold common stock to investors in various states. Certain of those offerings may not have complied with various requirements of applicable state securities laws. In such situations a number of remedies may be available to regulatory authorities and the investors who purchased common stock in those offerings, including, without limitation, a right of rescission, civil penalties, seizure of our assets, a restraining order or injunction, and a court order to pay restitution and costs. As a result, certain investors in our common stock may be entitled to return their shares to Overstock.com and receive from us the full price they paid, plus interest, which we estimate to be an aggregate amount of approximately $3.3 million at September 30, 2005.

Potential Stock Manipulation

We have filed an unfair business practice lawsuit against Gradient Analytics, Rocker Partners, L.P. and others, alleging that the defendants have conspired to denigrate Overstock s business for personal profit, as well as an amended complaint alleging additional causes of action and articulating in greater detail the allegations against the defendants. We believe that the defendants have engaged in unlawful actions and have caused substantial harm to Overstock, and that certain of the defendants have made efforts to drive the market price of Overstock s common stock down. To the extent that the defendants or other persons engage in any such actions or other take any other actions to interfere with or destroy or harm Overstock s existing and/or prospective business relationships with its suppliers, bankers, customers, lenders, investors, prospective investors or others, our business, prospects, financial condition and results of operation may suffer, and the price of our common stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of any such efforts.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments consist of cash and cash equivalents, marketable securities, trade accounts and contracts receivable, accounts payable and long-term obligations. We consider investments in highly-liquid instruments purchased 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.

In January 2005, the Company purchased $49.9 million in foreign corporate securities (Securities) which mature in September and November 2006. The Securities have a conditional coupon rate indexed to a basket of eight Asian currencies. At maturity, the Company will receive back its total initial investment in the Securities, plus additional coupon interest depending on the performance of the Asian currencies to the dollar. For example, if the Asian currencies strengthen in relation to the US dollar over the life of Securities, the coupon interest will be greater. If the inverse is true, the Company receives only a small interest payment in addition to its original investment. If the Company redeems the Securities prior to maturity, it may not realize the full amount of our initial investment.

Under SFAS No. 133, the Notes are considered to be derivative financial instruments and are marked to market quarterly. Any unrealized gain or loss related to the conditional coupon based on the quarterly mark-to-market valuation is recorded in the income statement as a component of interest income or expense. Any unrealized gain or loss related to the impact of the underlying Notes mark-to-market valuation is recorded as a component of other comprehensive income.

For the quarter ended September 30, 2005 the mark-to-market valuation of the conditional coupon resulted in a loss of $2.1 million, and a loss of $2.4 million for the nine months ended September 30, 2005. The mark-to-market valuation of the Notes resulted in a gain of $660,000 to be recorded as a component of other comprehensive income for the quarter and nine months ended September 30, 2005.

At September 30, 2005, we had $2.6 million in cash and cash equivalents and $74.2 million in marketable securities (including the foreign Notes). A hypothetical increase or decrease in interest rates of one hundred basis points would have an estimated impact of approximately $1.2 million on our earnings or loss, or the fair market value or cash flows of these instruments.

In June 2005, under the Share Buyback Program (see Note 11), the Company retired $33.0 million of its 3.75% Convertible Senior Notes (the Senior Notes), which were due on December 1, 2011 for $27.9 million in cash. As a result of the note retirement, the Company recognized a net gain of $4.2 million, net of the associated unamortized discount of $960,000. As of September 30, 2005, $87.0 million of the Senior Notes remained outstanding. The Senior Notes bear interest at a fixed rate of 3.75%. In addition, at September 30, 2005, there were no borrowings outstanding under our line of credit and letters of credit totaling $11.2 million were outstanding under our credit facility.

The fair value of the convertible senior notes is sensitive to interest rate changes. Interest rate changes would result in increases or decreases in the fair value of the convertible senior notes, due to differences between market interest rates and rates in effect at the inception of the obligation. Unless we elect to repurchase our convertible senior notes in the open market, changes in the fair value of convertible senior notes have no impact on our cash flows or consolidated financial statements. The estimated fair value of the convertible senior notes was $67.9 million at September 30, 2005.

In January 2005, our Board of Directors authorized a stock repurchase program for up to $50.0 million of our common stock through December 31, 2007. In April 2005, the Board of Directors increased the stock repurchase program to $100.0 million. Additionally, on June 14, 2005, the Board of Directors amended the stock repurchase program to include the repurchase of the Company s Convertible Senior Notes. Under the program, shares may be purchased as determined by management, from time to time and within certain guidelines, in the open market or in privately negotiated transactions, including privately negotiated structured stock repurchase transactions and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time to time without prior notice.

Under the buyback program, the Company repurchased approximately 665,000 shares of its common stock in open market transactions for $24.1 million during the nine months ended September 30, 2005. In addition, approximately 1.0 million shares of common stock were acquired as a result of the settlement of $39.6 million of structured stock repurchase transactions during the nine months ended September 30, 2005. The structured stock repurchase transactions that did not settle in stock settled in cash totaling $7.9 million which we received in July 2005. These transactions are recorded in shareholder s equity in the accompanying consolidated balance sheets.

ITEM 4. CONTROLS AND PROCEDURES

Restatement

As discussed in Note 2 to the consolidated financial statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q/A, and Item 4.02 (a) of the Company s Current Report on Form 8-K filed with the Commission on February 27, 2005, management of the Company has amended its Annual Report on Form 10-K for the year ended December 31, 2004, to restate the Company s annual consolidated financial statements as of and for the years ended December 31, 2004, 2003 and 2002 and the quarterly consolidated financial statements for each of the quarters within the years ended December 31, 2004 and 2003 and the consolidated financial statements for the quarters ended September 30, 2005 and 2004, June 30, 2005 and 2004 and March 31, 2005 and 2004 included in the Company s Quarterly Reports on Form 10-Q for the quarters ended September 30, 2005, June 30, 2005 and March 31, 2005. The determination to restate these consolidated financial statements was made as a result of management s identification of an error related to the accounting for freight costs incurred to deliver inventory to its warehouses. The Company has determined that the misstatement relates to the Company s former practice of immediately expensing inbound freight costs in the period incurred rather than capitalizing such costs as a component of inventory and expensing such costs as the related inventory is sold.

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to management, including the President (principal executive officer) and Senior Vice President, Finance (principal financial officer), as appropriate, to allow timely decisions regarding required disclosure.

As a result of the restatement discussed above, management of the Company, under the supervision and with the participation of the Company s President (principal executive officer) and Senior Vice President, Finance (principal financial officer), has re-evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in the Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report, September 30, 2005. Based upon this re-evaluation, the Company s management, including its President (principal executive officer) and Senior Vice President, Finance (principal financial officer), have concluded that its disclosure controls and procedures were not effective as of September 30, 2005. The Company s management nevertheless has concluded that the consolidated financial statements included in this Quarterly Report on Form 10-Q/A present fairly, in all material respects, the Company s financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America.

Material Weakness in Internal Control Over Financial Reporting

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of September 30, 2005, the Company did not maintain effective controls over its accounting for inventory. Specifically, the Company did not have effective controls designed and in place to ensure that inbound freight costs were completely and accurately capitalized as a component of inventory costs in accordance with generally accepted accounting principles. This control deficiency resulted in the restatement of the Company s annual consolidated financial statements as of and for the years ended December 31, 2004, 2003 and 2002 and the Interim consolidated financial statements for each of the quarters within the years ended December 31, 2005, 2004 and 2003. Additionally, this control deficiency could result in a misstatement of our inventory and cost of goods sold that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

Remediation Steps to Address Material Weakness

To remediate the material weakness in the Company s internal control over financial reporting and the ineffectiveness of its disclosure controls and procedures and in connection with the preparation and filing of this Amended Quarterly Report on Form 10-Q/A, the Company has conducted and completed a review of its accounting practices for accounting for inbound freight costs as a component of inventory costs and corrected its method of accounting. These steps were completed subsequent to December 31, 2005 but prior to the filing date of the Amendment.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting that occurred during the quarter ended September 30, 2005 that materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

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

In December 2003, we received a letter from Furnace Brook claiming that certain of our business practices and our on-line ordering system infringe a patent owned by Furnace Brook. After diligent efforts to show that we do not infringe these patents and Furnace Brook s continual assertions that it would vigorously protect its intellectual property rights if we did not agree to enter into licensing arrangements with respect to the asserted patents, on August 12, 2005, we filed a complaint in the United States District Court of Utah, Central Division, seeking declaratory judgment that we do not infringe any valid claim of the Furnace Brook patent. Furnace Brook filed a motion to dismiss our complaint for lack of personal jurisdiction over Furnace Brook in Utah. On October 31, 2005, the United States District Court of Utah, Central Division, issued a decision to dismiss our complaint for lack of personal jurisdiction over Furnace

Brook. We are currently considering the benefits of motions for reconsideration or appeal of the Utah decision. On August 18, 2005, shortly after we filed the complaint in Utah, Furnace Brook filed a complaint in the United States District Court for the Southern District of New York, alleging that certain of our business practices and our on-line ordering system infringe a single patent owned by Furnace Brook. On September 12, 2005, we filed a motion to stay the proceedings in New York pending resolution of the issues related to the motion to dismiss in Utah. An answer to the New York complaint is not due until after resolution of the motion to stay. Although we believe to have defenses to the infringement allegations in the New York case, which we intend to pursue vigorously, the Furnace Brook lawsuit is not yet in the discovery stage, and we do not have sufficient information to assess the validity of the claims or the amount of potential damages.

On August 11, 2005, along with a shareholder plaintiff, we filed a complaint against Gradient Analytics, Inc.; Rocker Partners, LP; Rocker Management, LLC; Rocker Offshore Management Company, Inc. and their respective principal. We, along with a second shareholder plaintiff, filed the complaint in the Superior Court of California, County of Marin. On October 12, 2005, we filed an amended complaint against the same entities alleging libel, intentional interference with prospective economic advantage and violations of California s unfair business practices act. The defendants have been served with, but have not yet answered, the amended complaint. We intend to pursue this action vigorously.

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

During the quarterly period ended September 30, 2005, we issued 446,267 shares of our common stock upon the exercise of warrants with a weighted average exercise price of $6.82 per share. The issuance of these securities was deemed to be exempt from registration under Section 4(2) of the Securities Act of 1933 as a transaction by an issuer not involving a public offering.

The following table sets forth all purchases made by or on behalf of the Company or any affiliated purchaser as defined in Rule 10b-18(a)(3) under the Exchange Act, of shares of the Company s common stock made during each month within the third quarter of 2005, including all purchases made pursuant to publicly announced plans or programs and those not made pursuant to publicly announced plans or programs. Column (a) sets forth the total number of shares purchased, and the footnotes to the table disclose the number of shares purchased other than pursuant to a publicly announced plan or program and the nature of any such purchases. Column (b) sets forth the average price paid per share. Column (c) sets forth the total number of shares purchased as part of publicly announced repurchase plans or programs. Column (d) sets forth the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs.

The footnotes to the table indicate the date each plan or program was announced, the dollar amount or share amount approved, the expiration date, if any, of each plan or program, each plan or program that has expired during the period covered by the table, and each plan or program the Company has determined to terminate prior to expiration, or under which the Company does not intend to make further purchases.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share or Unit	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
				$ 8,362,000(2)
July 1, 2005 to July 31, 2005				$
August 1, 2005 to August 31, 2005	45,500	$ 43.97		$
September 1, 2005 to September 30, 2005	200,000	$ 40.19		$
Total	245,500(1)	$ 40.89		$ 8,362,000

(1) All shares were in column (a) were purchased by the Company s President, Patrick M. Byrne, and the Company s Chairperson, Mr. Jack Byrne, who may be deemed to be an affiliated purchaser as defined in Rule 10b-18(a)(3) under the Exchange Act. None of the shares purchased were purchased by the Company.

(2) The Company announced a $50.0 million stock repurchase program on January 26, 2005, announced the expansion of the program to $100.0 million on April 26, 2005, and announced the expansion of the program to include possible repurchases of the Company s convertible senior notes on June 14, 2005. The expiration date of the program is January 26, 2008.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None.

ITEM 6. **EXHIBITS**

(a)	**Exhibits**
31	Rule 13a-15(d)/15d-15(d) Certifications
32	Section 1350 Certifications

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.

OVERSTOCK.COM, INC.
/s/ David K. Chidester
David K. Chidester
Senior Vice President, Finance

Dated: March 13, 2006