OVERSTOCK.COM, INC
Form 10-Q
October 24, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(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, 2013

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	(801) 947-3100
(Address, including zip code, of Registrant's principal executive offices)	(Registrant's telephone number, including area code)

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

There were 23,774,066 shares of the Registrant’s common stock, par value $0.0001, outstanding on October 21, 2013.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.
Consolidated Balance Sheets (Unaudited)
(in thousands)

	September 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$84,862	$93,547
Restricted cash	1,780	1,905
Accounts receivable, net	14,672	19,273
Inventories, net	22,733	26,464
Prepaid inventories, net	1,926	1,912
Prepaids and other assets	13,062	12,897
Total current assets	139,035	155,998
Fixed assets, net	26,892	21,037
Precious metals	8,560	—
Goodwill	2,784	2,784
Other long-term assets, net	2,167	2,166
Total assets	$179,438	$181,985
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$54,685	$62,416
Accrued liabilities	45,412	47,674
Deferred revenue	29,858	38,411
Total current liabilities	129,955	148,501
Other long-term liabilities	1,147	2,522
Total liabilities	131,102	151,023
Commitments and contingencies (Note 5)	0	0
Stockholders’ equity:		
Preferred stock, $0.0001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none	—	—
Common stock, $0.0001 par value		
Authorized shares - 100,000		
Issued shares - 26,898 and 26,481		
Outstanding shares - 23,774 and 23,451	2	2
Additional paid-in capital	360,730	356,895
Accumulated deficit	(232,168)	(247,096)
Treasury stock:		
Shares at cost - 3,124 and 3,030	(80,228)	(78,839)
Total stockholders’ equity	48,336	30,962
Total liabilities and stockholders’ equity	$179,438	$181,985

See accompanying notes to consolidated financial statements.

3

Table of Contents

Overstock.com, Inc.
Consolidated Statements of Income and Comprehensive Income (Unaudited)
(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue, net				
Direct	$35,681	$34,215	$113,873	$109,048
Fulfillment partner	265,745	221,137	792,751	648,207
Total net revenue	301,426	255,352	906,624	757,255
Cost of goods sold				
Direct(1)	30,777	30,684	99,768	99,422
Fulfillment partner	211,499	178,126	630,931	520,614
Total cost of goods sold	242,276	208,810	730,699	620,036
Gross profit	59,150	46,542	175,925	137,219
Operating expenses:				
Sales and marketing(1)	22,463	14,899	60,376	42,886
Technology(1)	17,259	16,085	53,339	46,845
General and administrative(1)	15,970	13,828	47,643	43,166
Restructuring	—	(45)	(471)	53
Total operating expenses	55,692	44,767	160,887	132,950
Operating income	3,458	1,775	15,038	4,269
Interest income	34	30	100	86
Interest expense	(33)	(194)	(121)	(655)
Other income, net	165	1,213	360	2,364
Income before income taxes	3,624	2,824	15,377	6,064
Provision for income taxes	91	131	449	182
Net income	$3,533	$2,693	$14,928	$5,882
Net income per common share—basic:				
Net income attributable to common shares—basic	$0.15	$0.11	$0.63	$0.25
Weighted average common shares outstanding—basic	23,766	23,447	23,692	23,382
Net income per common share—diluted:				
Net income attributable to common shares—diluted	$0.14	$0.11	$0.61	$0.25
Weighted average common shares outstanding—diluted	24,446	23,754	24,297	23,511
Comprehensive income	$3,533	$2,693	$14,928	$5,882

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

Cost of goods sold — direct	$37	$74	$117	$200
Sales and marketing	44	108	123	260
Technology	33	218	235	585
General and administrative	695	580	1,902	1,579
Total	$809	$980	$2,377	$2,624

See accompanying notes to consolidated financial statements.

Table of Contents

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

	Common stock		Additional Paid-in	Accumulated	Treasury stock		
	Shares	Amount	Capital	Deficit	Shares	Amount	Total
Balances at December 31, 2012	26,481	$2	$356,895	$(247,096)	3,030	$(78,839)	$30,962
Net income	—	—	—	14,928	—	—	14,928
Stock-based compensation to employees and directors	—	—	2,377	—	—	—	2,377
Common stock issued upon vesting of restricted stock	334	—	—	—	—	—	—
Exercise of stock options	83	—	1,458	—	—	—	1,458
Purchase of treasury stock	—	—	—	—	94	(1,389)	(1,389)
Balances at September 30, 2013	26,898	$2	$360,730	$(232,168)	3,124	$(80,228)	$48,336

See accompanying notes to consolidated financial statements.

Table of Contents

Overstock.com, Inc.
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	Nine months ended September 30,		Twelve months ended September 30,	
	2013	2012	2013	2012
Cash flows from operating activities:				
Net income	$14,928	$5,882	$23,715	$2,473
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	10,833	11,935	14,907	15,813
Realized gain from sale of marketable securities	(28)	(8)	(29)	(8)
Loss on disposition of fixed assets	—	72	—	72
Stock-based compensation to employees and directors	2,377	2,624	3,280	3,264
Amortization of debt discount and deferred loan costs	14	55	32	105
Loss on investment in precious metals	475	—	475	—
Loss from early extinguishment of debt	—	—	—	1,199
Restructuring charges (reversals)	(471)	53	(448)	53
Changes in operating assets and liabilities:				
Restricted cash	125	(24)	280	323
Accounts receivable, net	4,601	(519)	(652)	(5,575)
Inventories, net	3,731	1,603	(1,343)	(2,180)
Prepaid inventories, net	(14)	(641)	(258)	(253)
Prepaids and other assets	(2,995)	(314)	(1,387)	2,448
Other long-term assets, net	(445)	(1,160)	448	(1,332)
Accounts payable	(7,779)	(26,958)	11,277	761
Accrued liabilities	(2,308)	(7,478)	4,711	2,981
Deferred revenue	(8,553)	836	1,044	7,634
Other long-term liabilities	(707)	705	(786)	848
Net cash provided by (used in) operating activities	13,784	(13,337)	55,266	28,626
Cash flows from investing activities:				
Purchases of marketable securities	(111)	(69)	(124)	(110)
Purchases of intangible assets	(13)	(6)	(13)	(3)
Sales of marketable securities	291	154	291	154
Investment in precious metals	(5,980)	—	(7,377)	—
Expenditures for fixed assets, including internal-use software and website development	(13,970)	(10,563)	(15,896)	(12,960)
Proceeds from sale of fixed assets	—	56	—	56
Net cash used in investing activities	(19,783)	(10,428)	(23,119)	(12,863)
Cash flows from financing activities:				
Payments on capital lease obligations	(2,563)	(112)	(2,563)	(188)
Payments on line of credit	—	—	(17,000)	—
Capitalized financing costs	—	—	—	(19)
Payments on finance obligations	—	—	—	(21,528)
Paydown on direct financing arrangement	(192)	(175)	(253)	(231)
Proceeds from exercise of stock options	1,458	—	1,458	—
Purchase of treasury stock	(1,389)	(464)	(1,396)	(466)
Net cash used in financing activities	(2,686)	(751)	(19,754)	(22,432)
Net increase (decrease) in cash and cash equivalents	(8,685)	(24,516)	12,393	(6,669)

Cash and cash equivalents, beginning of period	93,547	96,985	72,469	79,138
Cash and cash equivalents, end of period	$84,862	$72,469	$84,862	$72,469
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid	$56	$436	$202	$991
Taxes paid	598	139	758	139
Non-cash investing and financing activities:				
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	$89	$581	$10	$278
Equipment acquired under capital lease obligations	2,563	—	2,563	—

See accompanying notes to consolidated financial statements.

6

Table of Contents

Overstock.com, Inc.
Notes to Unaudited Consolidated Financial Statements

1. BASIS OF PRESENTATION

As used herein, “Overstock,” “Overstock.com,” “O.co,” “we,” “our” and similar terms include Overstock.com, Inc. and its subsidiaries, unless the context indicates otherwise. We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations and our audited annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2012. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of results for the interim periods presented. Preparing financial statements requires us to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

2. ACCOUNTING POLICIES

Principles of consolidation

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

Use of estimates

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

Cash equivalents

We classify all highly liquid instruments, including money market funds with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were $58.1 million and $76.2 million at September 30, 2013 and December 31, 2012, respectively.

Restricted cash

We consider cash that is legally restricted and cash that is held as a compensating balance for letter of credit arrangements as restricted cash. Restricted cash was $1.8 million and $1.9 million at September 30, 2013 and December 31, 2012, respectively.

Fair value of financial instruments

Our financial instruments, including cash, cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these instruments.

We account for our assets and liabilities using a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources,

Table of Contents

while unobservable inputs reflect our market assumptions. These two types of inputs have created the following fair-value hierarchy:

- Level 1—Quoted prices for identical instruments in active markets;
- Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

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

The fair value of these financial instruments was determined using the following levels of inputs as of September 30, 2013 (in thousands):

	Fair Value Measurements at September 30, 2013:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$58,078	$58,078	$—	$—
Trading securities held in a “rabbi trust” (1)	110	110	—	—
Total assets	$58,188	$58,188	$—	$—
Liabilities:				
Deferred compensation accrual “rabbi trust” (2)	$240	$240	$—	$—
Total liabilities	$240	$240	$—	$—

The fair value of these financial instruments was determined using the following levels of inputs as of December 31, 2012 (in thousands):

	Fair Value Measurements at December 31, 2012:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	$76,248	$76,248	$—	$—
Trading securities held in a “rabbi trust” (1)	264	264	—	—
Total assets	$76,512	$76,512	$—	$—
Liabilities:				
Deferred compensation accrual “rabbi trust” (2)	$266	$266	$—	$—
Restructuring (3)	65	—	—	65
Total liabilities	$331	$266	$—	$65

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

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

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

Restricted investments

We have a Non Qualified Deferred Compensation Plan (the "NQDC Plan") for senior management. Deferred compensation amounts are invested in mutual funds held in a "rabbi trust" and are restricted for payment to the participants of the NQDC Plan. We account for our investments held in the trust in accordance with Accounting Standards Codification

Table of Contents

("ASC") No. 320 "Investments — Debt and Equity Securities". The investments held in the trust are classified as trading securities. The fair value of the investments held in the trust totaled $110,000 at September 30, 2013 and are included in Other current and long-term assets in the consolidated balance sheets. Our gains and losses on these investments were immaterial for the three and nine months ended September 30, 2013 and 2012.

Accounts receivable

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

Allowance for doubtful accounts

From time to time, we grant credit to some of our business customers on normal credit terms (typically 30 days). We perform credit evaluations of our business customers' financial condition and payment history and maintain an allowance for doubtful accounts receivable based upon our historical collection experience and expected collectability of accounts receivable. The allowance for doubtful accounts receivable was $160,000 and $797,000 at September 30, 2013 and December 31, 2012, respectively. The decrease in the allowance for doubtful accounts was primarily due to write-offs of accounts receivable during the nine months ended September 30, 2013, which had no effect on results of operations for the period as the items had been previously reserved.

Concentration of credit risk

Cash equivalents include short-term, highly liquid instruments with maturities at date of purchase of three months or less. At September 30, 2013 and December 31, 2012, two banks held the majority of our cash and cash equivalents. We do not believe that, as a result of this concentration, we are subject to any unusual financial risk beyond the normal risk associated with commercial banking relationships.

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

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

Valuation of inventories

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

Prepaid inventories, net

Prepaid inventories represent inventories paid for in advance of receipt. Prepaid inventories were $1.9 million and $1.9 million at September 30, 2013 and December 31, 2012, respectively.

Prepaids and other assets

Prepaids and other assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs. Total prepaids and other assets were $13.1 million at September 30, 2013 and $12.9 million, including precious metals of $3.1 million, at December 31, 2012.

Table of Contents

Fixed assets

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

	Life (years)
Computer software	2-4
Computer hardware	3-4
Furniture and equipment	3-5

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Cost of goods sold - direct	$87	$123	$292	$350
Technology	2,937	3,371	9,595	10,570
General and administrative	283	345	946	1,015
Total depreciation and amortization, including internal-use software and website development	$3,307	$3,839	$10,833	$11,935

Internal-use software and website development

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

During the three months ended September 30, 2013 and 2012, we capitalized $3.3 million and $3.0 million, respectively, of costs associated with internal-use software and website development, both developed internally and acquired externally. Amortization of costs associated with internal-use software and website development was $1.8 million and $2.0 million for those respective periods. During the nine months ended September 30, 2013 and 2012, we capitalized $8.1 million and $6.8 million, respectively, of such costs and had amortization of $5.9 million and $6.3 million for those respective periods.

Leases

We account for lease agreements as either operating or capital leases depending on certain defined criteria. In certain of our lease agreements, we receive rent holidays and other incentives. We recognize lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays, that defer the commencement date of required payments. Additionally, tenant improvement allowances are amortized as a reduction in rent expense over the term of the lease. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life or the life of the lease, without assuming renewal features, if any, are exercised.

Treasury stock

We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity.

Other long-term assets

Other long-term assets consist primarily of long-term prepaid expenses.

Impairment of long-lived assets

Table of Contents

We review property and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability is measured by comparison of the assets' carrying amount to future undiscounted net cash flows the asset group is expected to generate. Cash flow forecasts are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. If such asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the three months ended September 30, 2013 and the year ended December 31, 2012.

Precious Metals

Our investments in precious metals were $8.6 million at September 30, 2013. At December 31, 2012, our investments in precious metals were $3.1 million and were included in Prepaids and other assets in our Consolidated Balance Sheets. At September 30, 2013 these investments were comprised of $4.5 million in gold and $4.1 million in silver and are stored at an off-site secure facility. Because these assets consist of actual precious metals, rather than financial instruments, we account for them as a cost method investment initially recorded at cost (including transaction fees) and then adjusted to the lower of cost of market based on an average unit cost. On an interim basis, we recognize decreases in the value of these assets caused by market declines. Subsequent increases in the value of these assets through market price recoveries during the same fiscal year are recognized in the later interim period, but may not exceed the total previously recognized decreases in value during the same year. Gains or losses resulting from changes in the value of our precious metal assets are recorded in Other income, net in our Consolidated Statements of Income and Comprehensive Income. Losses on investments in precious metals were $93,000 and $475,000 for the three and nine months ended September 30, 2013, respectively. There were no losses on investments in precious metals for the three and nine months ended September 30, 2012.

Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the tangible net assets acquired in business combinations.

Goodwill is not amortized but is tested for impairment at least annually. When evaluating whether goodwill is impaired, we make a qualitative assessment to determine if it is more likely than not that its fair value is less than its carrying amount. If the qualitative assessment determines that it is more likely than not that its fair value is less than its carrying amount, we compare the fair value of the reporting unit to which the goodwill is assigned to its carrying amount. If the carrying amount exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss, if any, is calculated by comparing the implied fair value of the goodwill to its carrying amount. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to the other assets and liabilities within the reporting unit based on estimated fair value. The excess of the fair value of a reporting unit over the amount allocated to its other assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized when the carrying amount of goodwill exceeds its implied fair value.

In accordance with this guidance, we test for impairment of goodwill in the fourth quarter or when we deem that a triggering event has occurred. Goodwill totaled $2.8 million at September 30, 2013 and December 31, 2012. There were no impairments to goodwill recorded during the three months ended September 30, 2013 or the year ended December 31, 2012.

Revenue recognition

We derive our revenue primarily from direct revenue and fulfillment partner revenue from merchandise sales. We also earn revenue from advertising on our shopping and other pages. We have organized our operations into two principal segments based on the primary source of revenue: direct revenue and fulfillment partner revenue (see Note 8—Business Segments).

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

Table of Contents

delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

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

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

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

Direct revenue

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

Fulfillment partner revenue

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

Consignment

We offer a consignment service to suppliers where the suppliers' merchandise is stored in and shipped from our warehouses. We pay the consignment supplier upon shipment of the consigned merchandise to the consumer. Revenue from consignment service business was less than 1% of total net revenues for the three and nine months ended September 30, 2013 and 2012, and is included in fulfillment partner segment on a gross basis.

International business

At September 30, 2013, we were offering products to customers in over 100 countries and non-U.S. territories. We do not have sales operations outside the United States, and are using a U.S. based third party to provide logistics and fulfillment for all international orders. Revenue generated from our international business is included in either direct or fulfillment partner revenue, depending on whether the product is shipped from our warehouses or from a fulfillment partner. International sales were less than 1% of total net revenues for the three and nine months ended September 30, 2013 and 2012.

Ecommerce marketplace channels

During 2012, we began offering some of our products for sale in online marketplaces of other Internet retailers' websites, which allows us to reach a broader potential customer base. Under the terms of our agreements with these ecommerce marketplace retailers, the retailers typically earn a fee that is a percentage of the selling price of the orders they send us. Revenue generated from these ecommerce marketplace channels is included in either direct or fulfillment partner revenue, on a gross basis, depending on whether the product is shipped from our warehouses or from a fulfillment partner. Ecommerce marketplace channels were approximately 2.1% and less than 1% of our total net revenues for the three months ended September 30, 2013 and 2012, respectively, and approximately 2.5% and less than 1% of our total net revenues for the nine months ended September 30, 2013 and 2012, respectively.

Other businesses

Table of Contents

We operate an online site for listing cars for sale as a part of our Website. The cars listing service allows dealers to list vehicles for sale and allows buyers to review vehicle descriptions and post offers to purchase, and provides the means for prospective purchasers to contact sellers for further information and negotiations on the purchase of an advertised vehicle. Revenue from the cars listing business is included in the fulfillment partner segment on a net basis. Revenue from our other businesses is less than 1% of total net revenues for the three and nine months ended September 30, 2013 and 2012.

Club O loyalty program

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

We recognize revenue for Club O reward dollars when customers redeem their reward dollars as part of a purchase at our Website. We recognize other income when Club O reward dollars expire or the likelihood of reward dollars being redeemed by a customer is remote ("reward dollar breakage"). Reward dollar breakage is currently recognized when the reward dollars expire.

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

Co-branded credit card program

We have a co-branded credit card agreement with a commercial bank for the issuance of credit cards bearing the Overstock.com brand, under which the bank pays us fees for new accounts and for customer usage of the cards. The agreement also provides for a customer loyalty program offering reward points that customers will accrue from card usage and can use to make purchases on our Website (see "Club O loyalty program" above for more information). New account fees are recognized as revenue on a straight-line basis over the remaining life of the credit card relationship which runs through April 2015. Credit card usage fees are recognized as revenues as actual credit card usage occurs. Revenues from new account and credit card usage fees were less than 1% of total net revenues for all periods presented.

Deferred revenue

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

Sales returns allowance

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

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

Table of Contents

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

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

The allowance for returns was $7.3 million and $10.6 million at September 30, 2013 and December 31, 2012 respectively. The decrease in allowance for returns at September 30, 2013 compared to December 31, 2012 is primarily due to decreased revenues mostly due to seasonality.

Credit card chargeback allowance

Revenue is recorded net of credit card chargebacks. We maintain an allowance for credit card chargebacks based on current period revenues and historical chargeback experience. The allowance for chargebacks was $48,000 and $182,000 at September 30, 2013 and December 31, 2012, respectively.

Cost of goods sold

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

	Three months ended September 30,						Nine months ended September 30,					
	2013			2012			2013			2012		
Total revenue, net	$301,426	100	%	$255,352	100	%	$906,624	100	%	$757,255	100	%
Cost of goods sold												
Product costs and other cost of goods sold	228,963	76	%	196,522	77	%	690,563	76	%	582,436	77	%
Fulfillment and related costs	13,313	4	%	12,288	5	%	40,136	4	%	37,600	5	%
Total cost of goods sold	242,276	80	%	208,810	82	%	730,699	81	%	620,036	82	%
Gross profit	$59,150	20	%	$46,542	18	%	$175,925	19	%	$137,219	18	%

Advertising expense

We expense the costs of producing advertisements the first time the advertising takes place and expense the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized as incurred based on the terms of the individual agreements, which are generally: 1) a commission for traffic driven to the Website that generates a sale or 2) a referral fee based on the number of clicks on keywords or links to our Website generated during a given period. Advertising expense is included in sales and marketing expenses and totaled $20.2 million and $12.8 million during the three months ended September 30, 2013 and 2012, respectively. For the nine months ended September 30, 2013 and 2012, advertising expenses totaled $53.5 million and $37.0 million, respectively. Prepaid advertising (included in Prepaids and other assets in the accompanying consolidated balance sheets) was $2.1 million and $1.2 million at September 30, 2013 and December 31, 2012, respectively.

Stock-based compensation

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

Loss contingencies

Table of Contents

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

Restructuring

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

Income taxes

Our tax provision from income taxes for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes, we make a cumulative adjustment.

At September 30, 2013 and December 31, 2012, we have a full valuation allowance against our deferred tax assets, net of expected reversals of existing deferred tax liabilities, as we believe it is more likely than not that these benefits will not be realized. Significant judgment is required in making this assessment, and it is very difficult to predict when our assessment may conclude that the remaining portion of the deferred tax assets is realizable. To the extent that we remain profitable for the foreseeable future, the full or partial release of the valuation allowance could occur in the near term.

We have tax deductions from stock-based compensation that exceed the stock-based compensation recorded for such instruments. To the extent such excess tax benefits are ultimately realized, they will increase shareholders' equity. We utilize the with-and-without approach in determining if and when such excess tax benefits are realized, and under this approach excess tax benefits related to stock based compensation are the last to be realized.

Earnings per share

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income attributable to common shares	$3,533	$2,693	$14,928	$5,882
Net income per common share—basic:				

Net income attributable to common shares—basic	0.15	0.11	0.63	0.25
Weighted average common shares outstanding—basic	23,766	23,447	23,692	23,382
Effect of dilutive securities:				
Stock options and restricted stock awards	680	307	605	129
Weighted average common shares outstanding—diluted	24,446	23,754	24,297	23,511
Net income attributable to common shares—diluted	$0.14	$0.11	$0.61	$0.25

15

Table of Contents

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Stock options and restricted stock units	6	541	38	546

3. RESTRUCTURING EXPENSE

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

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

	Balance at 12/31/2012	Accretion Expense	Net Cash Payments	Adjustments	Balance at 9/30/2013
Lease and contract termination costs	$1,197	$55	$(268)	$(471)	$513

There were no lease termination costs reversed during the three months ended September 30, 2013. We reversed $471,000 of lease termination costs during the nine months ended September 30, 2013 primarily due to changes in our restructuring accrual as a result of our reoccupation of a portion of formerly restructured office space. We reversed $45,000 and incurred $53,000 of lease termination costs during the three months and nine months ended September 30, 2012, respectively, due to changes in the estimate of sublease income as a result of our entering into a revised agreement with a sub-lessee and ceasing the use of some of our office facilities.

4. BORROWINGS

U.S. Bank Financing Agreements

On December 26, 2012, we entered into a $3.0 million cash-collateralized line of credit agreement (the “Credit Agreement”) with U.S. Bank National Association (“U.S. Bank”) for the issuance of letters of credit. Advances under the Credit Agreement bear interest at one-month LIBOR plus 1.0%. The Credit Agreement matures on December 31, 2013. Amounts outstanding under the Credit Agreement were zero at September 30, 2013 and December 31, 2012.

Until December 31, 2012, we were party to a Financing Agreement with U.S. Bank (the “Financing Agreement”). In November 2012, we repaid all amounts outstanding under the Financing Agreement. The Financing Agreement expired in accordance with its terms on December 31, 2012. The maximum credit potentially available under the revolving facility was $20 million. Our obligations under the Financing Agreement and all related agreements were secured by all or substantially all of our assets, excluding our interest in certain litigation.

At September 30, 2013 and December 31, 2012, letters of credit totaling $1.8 million and $1.8 million, respectively, were issued on our behalf collateralized by compensating cash balances held at U.S. Bank, which are included in Restricted cash in the accompanying consolidated balance sheets.

U.S. Bank Commercial Purchasing Card Agreement

We have a commercial purchasing card (the “Purchasing Card”) agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At September 30, 2013, $865,000 was outstanding and $4.1 million was available under the Purchasing Card. At December 31, 2012, $3.9 million was outstanding and $1.1 million was available under the Purchasing Card.

Capital leases

16

Table of Contents

In March 2013, we entered into a capital lease arrangement for $2.6 million of computer equipment that will expire in 2017. We prepaid the entire $2.6 million shortly after entering into the agreement in order to obtain discounted pricing. As such, we have no future payment obligations under capital leases at September 30, 2013.

Fixed assets included assets under capital leases of $4.2 million and $1.7 million and accumulated depreciation related to assets under capital leases of $1.9 million and $1.7 million, at September 30, 2013 and December 31, 2012, respectively. Depreciation expense of assets recorded under capital leases was $161,000 and $1,000, for the three months ended September 30, 2013 and 2012, respectively and $268,000 and $221,000, for the nine months ended September 30, 2013 and 2012, respectively.

5. COMMITMENTS AND CONTINGENCIES

Summary of future minimum lease payments for all operating leases

Minimum future payments under all operating leases as of September 30, 2013, are as follows (in thousands):

Payments due by period	
2013 (remainder)	$2,658
2014	10,403
2015	8,161
2016	4,663
2017	3,922
Thereafter	36,263
	$66,070

Rental expense for operating leases totaled $2.6 million and $2.1 million for the three months ended September 30, 2013 and 2012, respectively and $7.2 million and $6.5 million for the nine months ended September 30, 2013 and 2012, respectively. Estimated sublease income of $29,000 is anticipated to be received in the next 12 months.

On May 13, 2013 we entered into a new operating lease for a warehouse facility that we have leased since September 2008. This lease extends the term of occupancy to August 31, 2026. The minimum future payments due under this new operating lease are included in the summary of future minimum lease payments for all operating leases in the table above.

Legal Proceedings

From time to time, we are involved in litigation concerning consumer protection, employment, intellectual property and other commercial matters related to the conduct and operation of our business and the sale of products on our Website. In connection with such litigation, we may be subject to significant damages. In some instances other parties may have contractual indemnification obligations to us. However, such contractual obligations may prove unenforceable or non-collectible, and in the event we cannot enforce or collect on indemnification obligations, we may bear the full responsibility for damages, fees and costs resulting from such litigation. We may also be subject to penalties and equitable remedies that could force us to alter important business practices. Such litigation could be costly and time consuming and could divert or distract our management and key personnel from our business operations. Due to the uncertainty of litigation and depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows.

On February 2, 2007, along with five shareholder plaintiffs, we filed a lawsuit in the Superior Court of California, County of San Francisco against Morgan Stanley & Co. Incorporated, Goldman Sachs & Co., Bear Stearns Companies, Inc., Bank of America Securities LLC, Bank of New York, Citigroup Inc., Credit Suisse (USA) Inc., Deutsche Bank Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc., and later amended the complaint to add Lehman Brothers Holdings Inc. as a defendant. The suit alleged that the defendants, who controlled over 80% of the prime brokerage market, participated in an illegal stock market manipulation scheme and that the defendants had no intention of covering short sell orders with borrowed stock, as they are required to do, causing what are referred to as “fails to deliver” and that the defendants’ actions caused and continued to cause dramatic declines in the share price of our stock and that the amount of “fails to deliver” often exceeded our entire supply of outstanding shares. The suit accused the defendants of violations of California securities laws and common law and violations of California’s Unfair Business Practices Act. After it filed for bankruptcy on

Table of Contents

September 2008, we elected not to pursue our claims against Lehman Brothers Holdings. On July 23, 2009, the court sustained defendants' demurrer to our amended causes of action for conversion and trespass to chattels. On December 15, 2010, we and the other plaintiffs in the case entered into a settlement agreement with certain of the defendants requiring these defendants to pay in the aggregate $4.5 million to plaintiffs. Other terms of settlement are confidential. At that time, remaining defendants in the suit were Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Execution & Clearing L.P., ("Goldman Defendants") Merrill Lynch, Pierce, Fenner & Smith, Inc., Merrill Lynch Professional Clearing Corporation ("Merrill Lynch Defendants), and Bank of America Securities LLC. On December 15, 2010, we filed a motion to amend our complaint against the Goldman and Merrill Lynch Defendants to add a cause of action based on the New Jersey Racketeer Influenced and Corrupt Organization (RICO) Act. Defendants challenged the RICO claim by demurrer and eventually the court sustained the demurrer. We thereafter entered a settlement agreement with Bank of America Securities LLC, the terms of which are confidential, and have dismissed the action as to that defendant. On August 19, 2011, the remaining defendants filed a motion for summary judgment. On January 10, 2012, the court granted the motion for summary judgment as to all remaining defendants and the judgment has been entered. We have appealed that decision and each side has appealed the trial court's decisions regarding sealing of certain records in the case. The defendants applied to the court for reimbursement from us of their allowable court costs in the collective amount of $2.4 million. We challenged the application, and the court reduced the amount to $689,471, which will be payable only if we do not succeed on our appeal of the summary judgment. The briefing of the appeals on both the records sealing and summary judgment is complete. The Court of Appeal has not set a date for oral argument. The nature of the loss contingencies relating to any court costs ordered against us are described above.

On May 30, 2008, we filed a complaint in New York state court against the New York State Department of Taxation and Finance, its Commissioner, the State of New York and its governor, alleging that a New York state tax law is unconstitutional. The effect of the New York law is to require Internet sellers to collect and remit New York sales taxes on their New York sales even if the seller has no New York tax "nexus" other than with New York based independent contractors who are Internet advertising affiliates. The complaint asks for the court to declare the law unconstitutional and enjoin its application to us. New York filed a motion to dismiss. We responded to the motion and filed a motion for summary judgment, and both motions were heard simultaneously. On January 12, 2009, the court granted New York's motion to dismiss and denied our motion for summary judgment. We appealed the decision, and the New York Appellate Division upheld part of the lower court's ruling rejecting our claims that the law is unconstitutional on its face, but remanded our claims that the law is unconstitutional as applied, for further discovery and proceedings in the lower court. We filed with the New York State Court of Appeals a motion of leave to appeal the portions of the decision upholding the lower court's ruling. On March 15, 2011, the Appellate Division of the New York State Court of Appeals denied our motion for leave to appeal to the New York State Court of Appeals. We determined not to pursue in the trial our claims that the law is unconstitutional as applied and proceeded with an appeal to the New York State Court of Appeals of the Appellate Division's ruling on our claim that the statute is unconstitutional on its face. On March 28, 2013, New York State Court of Appeals denied the appeal. We have petitioned the Supreme Court of the United States for a writ of certiorari. The Supreme Court has not ruled on our petition.

On August 12, 2008, we along with seven other defendants, were sued in the United States District Court for the Northern District of California, by Sean Lane, and seventeen other individuals, on their own behalf and for others similarly in a class action suit, alleging violations of the Electronic Communications Privacy Act, Computer Fraud and Abuse Act, Video Privacy Protection Act, and California's Consumer Legal Remedies Act and Computer Crime Law. The complaint relates to our use of a product known as Facebook Beacon, created and provided to us by Facebook, Inc. Facebook Beacon provided the means for Facebook users to share purchasing data among their Facebook friends. The parties extended by agreement the time for defendants' answer, including our answer, and thereafter, the Plaintiff and Facebook proposed a stipulated settlement to the Court for approval, which would resolve the case without requirement of financial contribution from us. On March 17, 2010, over objections lodged by some parties, the Court entered an order accepting settlement. Various parties appealed and on September 20, 2012, the Federal Appeals Court for the 9th Circuit upheld the settlement. Appealing parties petitioned for a rehearing. On February 26, 2013, the Court denied the petition. The appealing parties have petitioned the Supreme Court of the United States for a writ of certiorari. The Supreme Court has not ruled on the petition. The nature of the loss contingencies relating to claims that have been asserted against us are described above.

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

Table of Contents

Activity Tax, and owe $612,784 in taxes, interest, and penalties as of June 30, 2009. The Ohio Department of Taxation issued additional estimated assessments of estimated tax, interest and penalties totaling $170,322 as of September 30, 2013. We have filed protests to challenge the Department's Assessments on constitutional grounds and the matter is currently pending before the Ohio Department of Taxation's Legal Division for administrative review and determination. A hearing on these matters was held November 18, 2011. No administrative ruling has been issued following the hearing. We have reached an agreement in principle with the Ohio Department which would require our payment of a diminished amount of the estimated assessments, a reduction in interest and waiver of penalties. We are in the process of formalizing the agreement.

On March 10, 2009, we were sued in a class action filed in the United States District Court, Eastern District of New York. Cynthia Hines, the nominative plaintiff on behalf of herself and others similarly situated, seeks damages under claims for breach of contract, common law fraud and New York consumer fraud laws. The Plaintiff alleges we failed to properly disclose our returns policy to her and that we improperly imposed a "restocking" charge on her return of a vacuum cleaner. We filed a motion to dismiss based upon assertions that our agreement with our customers requires all such actions to be arbitrated in Salt Lake City, Utah. On December 31, 2010, Hines filed an amended complaint. The amended complaint eliminated common law fraud claims and breach of contract claims and added claims for breach of Utah's consumer protection statute and various other state consumer protection statutes. The amended complaint also asked for an injunction. We filed motions to dismiss and to decertify the class. On August 19, 2013, the court granted our motion and later dismissed the case. The time for filing a notice of appeal has passed, thus concluding the case.

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

On September 29, 2010, a trustee in bankruptcy filed against us an adversary proceeding in the matter of In re: Petters Company, Inc., a case filed in United States Bankruptcy Court, in the District of Minnesota. The complaint alleges principal causes of action against us under various Bankruptcy Code sections and the Minnesota Fraudulent Transfer Act, to recover damages for alleged transfers of property from the Petters Company occurring prior to the filing of the case initially as a civil receivership in October 2008. The trustee's complaint alleges such transfers occurred in at least one note transaction whereby we transferred at least $2.3 million and received in return transfers totaling at least $2.5 million. The trustee does not specify a date for the transactions; however we believe that any alleged transaction with the Petters Company would have taken place in excess of seven years from the date of the filing of the adversary proceeding. The case is in its early stages. We filed a motion to dismiss on statute of limitations and other grounds. The court consolidated the issues in our motion with issues raised by motion in similar trustee-filed cases having similar allegations and similar theories of recovery. The court has issued three separate orders containing legal rulings on these consolidated legal issues. We understand that the court will apply these rulings to the specific motions to dismiss, including the motion that we filed, at some point following an upcoming status conference in mid-November. While we expect the application of these rulings will limit the allegations asserted against us, we also expect that the judge will allow portions of the case to proceed to the discovery stage. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action.

On November 17, 2010, we were sued in the Superior Court of California, County of Alameda, by District Attorneys for the California Counties of Alameda, Marin, Monterey, Napa, Santa Clara, Shasta and Sonoma County, and the County of Santa Cruz later joined the suit. These district attorneys seek damages and an injunction under claims for violations of California consumer protection laws, alleging we made untrue or misleading statements concerning our pricing, price reductions, sources of products and shipping charges. The complaint asks for damages in the amount of not less than $15 million. We tried the case in early September 2013 before the judge of the court. Both sides are preparing final written

Table of Contents

arguments. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to vigorously defend this action.

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

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

On November 18, 2011, Smartfit Solutions, LLC filed suit against us and 43 other defendants in the United States District Court for the Eastern District of Texas for infringement of a patent covering certain "methods for presenting exercise protocols to a user and evaluating the effectiveness of the same." We tendered the defense of this action to an indemnitor which accepted the defense. The indemnitor reached a tentative settlement with the Plaintiff at no cost to us, and the case has now been dismissed.

On January 27, 2012, Pragmatus Telecom, LLC filed suit against us in the United States District Court for the District of Delaware for infringement of two patents covering a system for coordinating data and voice communications via customer contact channel changing system using voice over IP and infringement of one patent for coordinating data and voice communications via customer contact channel changing system. We have answered the complaint. We tendered the defense of the case to an indemnitor. The case against us was stayed July 10, 2012, pending resolution of a declaratory judgment action filed by our indemnitor against Pragmatus. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On March 1, 2012, H-W Technology, L.C. filed suit against us in the United States District Court in the Northern District of Texas for infringement of a patent entitled "Internet Protocol (IP) Phone with Search and Advertising Capability." We answered the complaint. On January 28, 2013, we filed a motion for summary judgment for invalidity on two claims of the patent. On September 23, 2013, the court granted the motion. We intend to apply to the court for court-ordered reimbursement of our legal fees and costs expended in our defense.

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

On July 16, 2012, Digitech Image Technologies, LLC filed against us and 45 other defendants in the United States District Court for the Central District of California for infringement of a patent covering the imaging technology that facilitates prediction of color and location within digital cameras. We tendered defense of the case to an indemnitor which accepted the defense. Following a ruling in our favor, the case was dismissed and in September 2012, Digitech filed a new complaint in the same court on the same infringement claims. In the new action, our indemnitor continues to defend the case and has filed a motion to stay on our behalf, which the Court granted on April 10, 2013. Subsequently, the court granted a motion for summary judgment on invalidity of the patent and entered judgment for us. Digitech has stated it will appeal the decision. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to cooperate with our indemnitor and vigorously defend this action.

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

On February 11, 2013, RPost Holdings, Inc., RPost Communications Limited, and RMail Limited, filed suit against us in the United States District Court in Eastern District of Texas for infringement of patents covering products and services that verify the delivery and integrity of email messages. We tendered defense of the case to an indemnitor which accepted the defense. We have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On April 23, 2013, Eclipse IP, LLC filed suit against us in the United States District Court in Eastern District of Texas for infringement of patents covering "secure notification messaging systems and methods using authentication indicia." We were served with the complaint on May 10, 2013, and have answered the complaint. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue our indemnification rights with our vendors.

On August 16, 2013, Online News Link LLC, LLC filed suit against us in the United States District Court in District of Delaware for infringement of patents covering data distribution systems that can make downloading data fast and efficient. We are presently examining whether we are indemnified by any vendor. We were served with the complaint on August 19, 2013. The case is in its early stages. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue any indemnification rights with our vendors.

On August 22, 2013, Guardian Media Technologies LTD filed suit against us in the United States District Court in the Eastern District of Texas for infringement of patents covering parental control features in DVD players and televisions. The suit relates to a prior lawsuit with Guardian filed in 2008 in which we signed a tolling agreement. We are presently examining whether we are indemnified by any vendor in this subsequent suit. We have not answered the complaint. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made. We intend to vigorously defend this action and pursue any indemnification rights with our vendors.

On September 30, 2013, Altaf Nazerali filed suit against us in the Supreme Court of British Columbia for vicarious liability for defamation, liable and slander. The suit relates to alleged representations about Nazerali found on the website www.deepcapture.com. The suit alleges that the representations were made by our Chief Executive Officer, Patrick Byrne, and two other employees. We have not answered the complaint. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no estimate of the loss or range of loss can be made.

We establish liabilities when a particular contingency is probable and estimable. At September 30, 2013, we have accrued $2.6 million in light of these probable and estimable liabilities. It is reasonably possible that the actual losses may exceed our accrued liabilities. We have other contingencies which are reasonably possible; however, the reasonably possible exposure to losses cannot currently be estimated.

6. INDEMNIFICATIONS AND GUARANTEES

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

Table of Contents

7. STOCK-BASED AWARDS

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Stock options	$—	$—	$—	$3
Restricted stock awards	809	980	2,377	2,621
Total stock-based compensation expense	$809	$980	$2,377	$2,624

Restricted stock awards

During the three and nine months ended September 30, 2013, the Compensation Committee of the Board of Directors approved grants of 2,500 and 275,000 restricted stock awards, respectively, to our officers, board members and employees. The restricted stock awards vest over three years at 40% at the end of the first year, 30% at the end of the second year and 30% at the end of the third year and are subject to the employee's continuing service to us. At September 30, 2013, there were 714,750 unvested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is either recognized on a straight line basis over the three-year vesting schedule or on an accelerated schedule when vesting of restricted stock awards exceeds a straight-line basis. The cumulative amount of compensation expense recognized at any point in time is at least equal to the portion of the grant date fair value of the award that is vested at that date. The weighted average grant date fair value of restricted stock awards granted during the three months and nine months ended September 30, 2013 was $33.44 and $16.12, respectively.

The following table summarizes restricted stock award activity during the nine months ended September 30, 2013 (in thousands):

	Nine months ended September 30, 2013	
	Units	Weighted Average Grant Date Fair Value
Outstanding—beginning of year	1,003	$ 8.81
Granted at fair value	275	16.12
Vested	(334)	10.14
Forfeited	(230)	9.41
Outstanding—end of period	714	$ 10.81

8. BUSINESS SEGMENTS

Segment information has been prepared in accordance with ASC Topic 280 Segment Reporting. Segments were determined based on how we manage the business. There were no inter-segment sales or transfers during the three and nine months ended September 30, 2013 and 2012. We evaluate the performance of our segments and allocate resources to them based primarily on gross profit. The table below summarizes information about reportable segments for the three and nine months ended September 30, 2013 and 2012 (in thousands):

22

Table of Contents

	Three months ended September 30,			Nine months ended September 30,		
	Direct	Fulfillment partner	Total	Direct	Fulfillment partner	Total
2013						
Revenue, net	$35,681	$265,745	$301,426	$113,873	$792,751	$906,624
Cost of goods sold	30,777	211,499	242,276	99,768	630,931	730,699
Gross profit	$4,904	$54,246	$59,150	$14,105	$161,820	$175,925
Operating expenses			55,692			160,887
Other income, net			166			339
Provision for income taxes			91			449
Net income			$3,533			$14,928
2012						
Revenue, net	$34,215	$221,137	$255,352	$109,048	$648,207	$757,255
Cost of goods sold	30,684	178,126	208,810	99,422	520,614	620,036
Gross profit	$3,531	$43,011	$46,542	$9,626	$127,593	$137,219
Operating expenses			44,767			132,950
Other income, net			1,049			1,795
Provision for income taxes			131			182
Net income			$2,693			$5,882

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

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

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

For the three and nine months ended September 30, 2013 and 2012, 99% of sales revenues were attributable to customers in the United States. At September 30, 2013 and December 31, 2012, all of our fixed assets were located in the United States.

Table of Contents

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

Special Note Regarding Forward-Looking Statements

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

- the anticipated benefits and risks of our business and plans;
- our ability to attract and retain customers in a cost-efficient manner;
- the effectiveness of our marketing;
- our future operating and financial results;
- the competition we face and will face in our business;
- the effects of government regulation;
- our future capital requirements and our ability to satisfy our capital needs;
- our expectations regarding the adequacy of our liquidity;
- our ability to retire or refinance any debt we may have;
- our plans for international markets, our expectations for our international sales efforts and the anticipated results of international operations;
- our plans for changes to our business;
- our beliefs regarding current or future litigation or regulatory actions;
- our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business;
- our beliefs regarding the adequacy of our insurance coverage;
- the adequacy of our infrastructure, including our backup facilities, cyber-security and our disaster planning;
- our belief that we can meet our published product shipping standards even during periods of relatively high sales activity;
- our belief that we can maintain or improve upon customer service levels that we and our customers consider acceptable;
- our beliefs regarding the adequacy of our order processing systems and our fulfillment and distribution capabilities;
- our beliefs and expectations regarding the adequacy of our office and warehouse facilities;
- our expectations regarding our car listing service and our community site, and the anticipated functionality and results of operations of them;
- our belief that we and our fulfillment partners will be able to maintain inventory levels at appropriate levels despite the seasonal nature of our business;
- our belief that our sales through other ecommerce marketplace channels will be successful and become an important part of our business; and
- our belief that we can successfully offer and sell a constantly changing mix of products and services.

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

- changes in U.S. and global economic conditions and consumer spending;
- world events;
- the rate of growth of the Internet and online commerce, and the occurrence of any event that would discourage or prevent consumers from shopping online;

- any failure to maintain our existing relationships or build new relationships with fulfillment partners on acceptable terms;
- any difficulties we may encounter maintaining optimal levels of product quality and selection or in attracting sufficient consumer interest in our product offerings;
- modifications we may make to our business model from time to time, including aspects relating to our product mix and the mix of direct/fulfillment partner sourcing of the products we offer;
- the mix of products purchased by our customers;
- problems with cyber security or data breaches or the costs of preventing or responding to any such problems;

Table of Contents

- problems with or affecting our credit card processors, including cyber-attacks, Internet or other infrastructure or communications impairment or other events that could interrupt the normal operation of the credit card processors;
- problems with the facility where substantially all of our computer and communications hardware is located or other problems that result in the unavailability of our Website or reduced performance of our transaction systems;
- difficulties we may have in responding to technological changes;
- problems with fraudulent purchases;
- problems we may encounter as a result of counterfeit items or the listing or sale of pirated, counterfeit or illegal items by third parties;
- difficulties we may have financing our operations or expansion with either internally generated funds or external sources of financing;
- the extent to which we owe income taxes or are required to collect sales taxes or to modify our business model in order to avoid being required to collect sales taxes;
- competition;
- difficulties with the management of our growth;
- fluctuations in our operating results;
- our efforts to expand internationally;
- the outcomes of legal proceedings, investigations and claims;
- our inability to optimize our warehouse operations;
- risks of inventory management and seasonality; and
- the other risks described in our public filings.

In evaluating all forward-looking statements, you should specifically consider the risks outlined above and in this Form 10-Q in Part II, Item 1A under the caption "Risk Factors." These factors may cause our actual results to differ materially from those contemplated by any forward-looking statement. Except as otherwise required by law, we expressly disclaim any obligation to release publicly any update or revisions to any forward-looking statements to reflect any changes in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements or other events.

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

Available Information

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

Overview

We are an online retailer offering discount brand name, non-brand name and closeout merchandise, including furniture, home décor, bedding and bath, housewares, jewelry and watches, apparel and designer accessories, electronics and computers, and sporting goods, among other products. We sell hundreds of thousands of best seller and current run books, magazines, CDs, DVDs and video games ("BMMG"). We sell these products and services through our Internet websites located at www.overstock.com, www.o.co and www.o.biz ("Website"). Although our three websites are located at different domain addresses, the technology and equipment and processes supporting the

Website and the process of order fulfillment described herein are the same for all three websites.

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

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

Table of Contents

Executive Commentary

This executive commentary is intended to provide investors with a view of our business through the eyes of our management. As an executive commentary, it necessarily focuses on selected aspects of our business. This executive commentary is intended as a supplement to, but not a substitute for, the more detailed discussion of our business included elsewhere herein. Investors are cautioned to read our entire “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as our interim and audited financial statements, and the discussion of our business and risk factors and other information included elsewhere or incorporated in this report. This executive commentary includes forward-looking statements, and investors are cautioned to read the “Special Note Regarding Forward-Looking Statements” at the beginning of Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Net income was $3.5 million in Q3 2013 compared to $2.7 million in Q3 2012. The $840,000 year-over-year improvement in net income resulted primarily from revenue growth of 18% and a 140 basis point improvement in gross margin (together, resulting in a $12.6 million increase in gross profit). This increase in gross profit was partially offset by a $10.9 million increase in operating expenses.

Revenues in Q3 2013 increased 18% compared to Q3 2012. The growth in revenue was primarily due to a 16% increase in average order size, from $147 to $170, coupled with a 2% increase in orders. The increase in average order size is largely due to a sales mix shift into the higher margin home and garden category.

Gross profit increased 27% compared to Q3 2012 primarily as a result of that revenue growth and a shift in product sales mix into higher margin home and garden products.

Sales and marketing expenses as a percentage of revenue increased from 5.8% to 7.5% during Q3 2013 as compared to the same period in 2012, primarily due to increased expenditures in the sponsored search marketing channel due to a higher proportion of our revenue coming through that channel.

During Q3 2013, Google, Inc. ("Google") tested and later implemented changes to its search engine algorithms, which reduced our ranking in certain Google search results, and slowed our revenue growth in the natural search channel. While we worked on adapting to Google's changes, we emphasized other marketing channels, such as sponsored search, which generated higher revenue growth but with higher marketing expenses as a percentage of revenue than is the case for natural search.

As a result, we had a 16% increase in Contribution (see “Non-GAAP Financial Measures” below for a reconciliation of Contribution to Gross Profit) compared to Q3 2012. Contribution margin was 12.2% for Q3 2013, and 12.4% for Q3 2012.

Technology expense in Q3 2013 increased $1.2 million compared to Q3 2012, primarily due to an increase in staff-related costs.

General and administrative expense in Q3 2013 increased $2.1 million compared to Q3 2012, primarily due to increased legal fees.

Legal fees increased during Q3 2013 due to increased activity on legal matters, including our defense of a case brought by district attorneys in eight California counties. We completed preparation for, and the bench trial of, this case during Q3 2013. We do not expect a verdict in this case for several months.

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

Table of Contents

Results of Operations

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(as a percentage of total net revenue)		(as a percentage of total net revenue)	
Revenue, net				
Direct	11.8 %	13.4 %	12.6 %	14.4 %
Fulfillment partner	88.2	86.6	87.4	85.6
Total net revenue	100.0	100.0	100.0	100.0
Cost of goods sold				
Direct	10.2	12.0	11.0	13.1
Fulfillment partner	70.2	69.8	69.6	68.8
Total cost of goods sold	80.4	81.8	80.6	81.9
Gross profit	19.6	18.2	19.4	18.1
Operating expenses:				
Sales and marketing	7.5	5.8	6.7	5.7
Technology	5.7	6.3	5.9	6.2
General and administrative	5.3	5.4	5.3	5.7
Restructuring	—	—	(0.1)	—
Total operating expenses	18.5	17.5	17.7	17.6
Operating income	1.1	0.7	1.7	0.5
Interest income	—	—	—	—
Interest expense	—	(0.1)	—	(0.1)
Other income, net	0.1	0.5	—	0.3
Net income before income taxes	1.2	1.1	1.7	0.8
Provision for income taxes	—	0.1	—	—
Net income	1.2 %	1.1 %	1.6 %	0.8 %

Comparisons of Three Months Ended September 30, 2013 to Three Months Ended September 30, 2012, and Nine Months Ended September 30, 2013 to Nine Months Ended September 30, 2012.

Revenue

The following table reflects our net revenues for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2013	2012	$ Change	% Change	2013	2012	$ Change	% Change
Revenue, net								
Direct	$35,681	$34,215	$1,466	4.3 %	$113,873	$109,048	$4,825	4.4 %
Fulfillment partner	265,745	221,137	44,608	20.2 %	792,751	648,207	144,544	22.3 %
Total revenue, net	$301,426	$255,352	$46,074	18.0 %	$906,624	$757,255	$149,369	19.7 %

The primary reason for increased total net revenue for the three and nine months ended September 30, 2013 was a 16% increase in average order size from $147 to $170, coupled with a 2% increase in orders, and a 20% increase in average order size from $136 to $163, respectively.

The primary reason for increased direct revenue for the three and nine months ended September 30, 2013 was a continued shift in sales mix into our home and garden products, partially offset by a decrease in sales of clothing and shoes due

Table of Contents

to a shift from a direct inventory-based model to a fulfillment partner-based model to reduce exposure from seasonal inventory and markdowns.

The primary reason for the increase in fulfillment partner revenue for the three and nine months ended September 30, 2013 was an increase in sales of home and garden products.

The shift of business from direct to fulfillment partner (or vice versa) is an economic decision based on the economics of each particular product offering at the time and we generally do not have particular goals for an “appropriate” mix or percentage for the size of either. We believe that the mix of the business between direct and fulfillment partner is consistent with our strategic objectives for our business model in the current economic environment and we do not currently foresee any material shifts in mix.

We continue to seek increased participation in our Club O loyalty program as we have seen revenue, average order size and gross profit from customers with paid Club O memberships grow faster than from other customers. For additional information regarding our Club O loyalty program see Item 1 of Part I, “Financial Statements (Unaudited)” —Note 2 —“Accounting Policies” under the section “Club O loyalty program.”

International sales were less than 1% of total net revenues for the three and nine months ended September 30, 2013 and 2012.

Change in estimate of average transit times (days)

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

The following table shows the effect that hypothetical changes in the estimate of average shipping transit times would have had on the reported amount of revenue and net income for the three months ended September 30, 2013 (in thousands):

	Three Months Ended September 30, 2013	
Change in the Estimate of Average Transit Times (Days)	Increase (Decrease) Revenue	Increase (Decrease) Net Income
2	$(9,652)	$(1,601)
1	$(4,072)	$(642)
As reported	As reported	As reported
-1	$2,858	$541
-2	$5,758	$1,039

See “Executive Commentary” above for additional discussion regarding revenue.

Gross profit and gross margin

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

Table of Contents

The following table reflects our net revenues, cost of goods sold and gross profit for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three months ended September 30,					Nine months ended September 30,				
	2013	2012	$ Change	% Change		2013	2012	$ Change	% Change	
Revenue, net										
Direct	$35,681	$34,215	$1,466	4.3	%	$113,873	$109,048	$4,825	4.4	%
Fulfillment partner	265,745	221,137	44,608	20.2	%	792,751	648,207	144,544	22.3	%
Total net revenues	$301,426	$255,352	$46,074	18.0	%	$906,624	$757,255	$149,369	19.7	%
Cost of goods sold										
Direct	$30,777	$30,684	$93	0.3	%	$99,768	$99,422	$		