

OVERSTOCK.COM, INC  
Form 10-Q  
November 03, 2016  
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-49799

OVERSTOCK.COM, INC.

(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)

799 West Coliseum Way, Midvale, Utah

84047

(Address of principal executive offices)

(Zip Code)

(801) 947-3100

(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  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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  No

There were 25,383,283 shares of the Registrant's common stock, par value \$0.0001, outstanding on October 31, 2016.

---

Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. <u>Financial Statements (Unaudited)</u>	<u>3</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>53</u>
Item 4. <u>Controls and Procedures</u>	<u>54</u>

PART II. OTHER INFORMATION

Item 1. <u>Legal Proceedings</u>	<u>56</u>
Item 1A. <u>Risk Factors</u>	<u>56</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>80</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>80</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>81</u>
Item 5. <u>Other Information</u>	<u>81</u>
Item 6. <u>Exhibits</u>	<u>81</u>
<u>Signature</u>	<u>82</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Overstock.com, Inc.

Consolidated Balance Sheets (Unaudited)

(in thousands)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 124,471	\$ 170,262
Restricted cash	430	430
Accounts receivable, net	21,045	16,128
Inventories, net	15,717	20,042
Prepaid inventories, net	1,537	1,311
Deferred tax assets, net	14,740	26,305
Prepays and other current assets	17,475	13,890
Total current assets	195,415	248,368
Fixed assets, net	136,594	93,696
Precious metals	9,722	9,722
Deferred tax assets, net	43,486	37,891
Intangible assets, net	11,688	14,656
Goodwill	14,698	15,387
Other long-term assets, net	12,673	8,669
Total assets	\$ 424,276	\$ 428,389
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 84,912	\$ 122,705
Accrued liabilities	77,957	83,387
Deferred revenue	41,257	50,944
Finance obligations, current	2,241	1,059
Other current liabilities, net	1,577	581
Total current liabilities	207,944	258,676
Long-term debt, net	39,502	8,843
Finance obligations, non-current	8,074	4,535
Other long-term liabilities	9,164	6,974
Total liabilities	264,684	279,028
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value:		
Authorized shares - 5,000		
Issued and outstanding shares - none	—	—
Common stock, \$0.0001 par value		
Authorized shares - 100,000		
Issued shares - 27,846 and 27,634		
Outstanding shares - 25,383 and 25,234	3	3
Additional paid-in capital	374,152	370,047
Accumulated deficit	(156,993	) (166,420 )

Edgar Filing: OVERSTOCK.COM, INC - Form 10-Q

Accumulated other comprehensive loss	(3,054	) (1,430	)
Treasury stock:			
Shares at cost - 2,463 and 2,400	(52,484	) (51,747	)
Equity attributable to stockholders of Overstock.com, Inc.	161,624	150,453	
Equity attributable to noncontrolling interests	(2,032	) (1,092	)
Total equity	159,592	149,361	
Total liabilities and stockholders' equity	\$ 424,276	\$ 428,389	

See accompanying notes to unaudited consolidated financial statements.

3

---

Table of Contents

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

	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Revenue, net				
Direct	\$24,620	\$33,621	\$75,901	\$104,184
Partner and other	416,944	357,590	1,197,880	1,073,384
Total net revenue	441,564	391,211	1,273,781	1,177,568
Cost of goods sold				
Direct(1)	23,955	31,989	72,459	95,751
Partner and other	337,893	286,771	967,977	860,272
Total cost of goods sold	361,848	318,760	1,040,436	956,023
Gross profit	79,716	72,451	233,345	221,545
Operating expenses:				
Sales and marketing(1)	34,707	30,062	99,516	86,121
Technology(1)	26,739	25,084	78,249	72,230
General and administrative(1)	23,317	20,676	67,843	60,639
Litigation settlement	—	—	(19,520)	—
Total operating expenses	84,763	75,822	226,088	218,990
Operating income (loss)	(5,047)	(3,371)	7,257	2,555
Interest income	73	37	228	118
Interest expense	(212)	(62)	(219)	(74)
Other income, net	1,251	764	9,399	2,532
Income (loss) before income taxes	(3,935)	(2,632)	16,665	5,131
Provision (benefit) for income taxes	(543)	(15)	8,178	3,774
Consolidated net income (loss)	\$(3,392)	\$(2,617)	\$8,487	\$1,357
Less: Net loss attributable to noncontrolling interests	(294)	(546)	(940)	(979)
Net income (loss) attributable to stockholders of Overstock.com, Inc.	\$(3,098)	\$(2,071)	\$9,427	\$2,336
Net income (loss) per common share—basic:				
Net income (loss) attributable to common shares—basic	\$(0.12)	\$(0.08)	\$0.37	\$0.10
Weighted average common shares outstanding—basic	25,356	24,681	25,326	24,402
Net income (loss) per common share—diluted:				
Net income (loss) attributable to common shares—diluted	\$(0.12)	\$(0.08)	\$0.37	\$0.10
Weighted average common shares outstanding—diluted	25,356	24,681	25,388	24,513

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

Cost of goods sold — direct	\$69	\$52	\$200	\$129
Sales and marketing	102	50	234	140
Technology	210	165	615	491
General and administrative	1,009	572	3,056	1,817
Total	\$1,390	\$839	\$4,105	\$2,577

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

Overstock.com, Inc.

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Consolidated net income (loss)	\$(3,392)	\$(2,617)	\$8,487	\$1,357
Other comprehensive loss:				
Unrealized loss on cash flow hedges, net of benefit (expense) for taxes of \$(346), \$581, \$718 and \$662	(64 )	(907 )	(1,624 )	(1,022 )
Other comprehensive loss	(64 )	(907 )	(1,624 )	(1,022 )
Comprehensive income (loss)	\$(3,456)	\$(3,524)	\$6,863	\$335
Less: Comprehensive loss attributable to noncontrolling interests	(294 )	(546 )	(940 )	(979 )
Comprehensive income (loss) attributable to stockholders of Overstock.com, Inc.	\$(3,162)	\$(2,978)	\$7,803	\$1,314

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

Overstock.com, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)  
(in thousands)Nine  
months  
ended  
September  
30, 2016

Equity attributable to stockholders of Overstock.com, Inc.

Number of common shares issued

Balance at beginning of period

27,634

Common stock issued upon vesting of restricted stock

212

Balance at end of period

27,846

Number of treasury stock shares

Balance at beginning of period

2,400

Purchases of treasury stock

63

Balance at end of period

2,463

Total number of outstanding shares

25,383

Common stock

\$3

Additional paid-in capital

Balance at beginning of period

\$370,047

Stock-based compensation to employees and directors

4,105

Balance at end of period

\$374,152

Accumulated deficit

Balance at beginning of period

\$(166,420)

Net income attributable to stockholders of Overstock.com, Inc.

9,427

Balance at end of period

\$(156,993)

Accumulated other comprehensive loss

Balance at beginning of period

\$(1,430 )

Net other comprehensive loss

(1,624 )

Balance at end of period

\$(3,054 )

Treasury stock

Balance at beginning of period

\$(51,747 )

Purchases of treasury stock

(737 )

Balance at end of period

(52,484 )

Total equity attributable to stockholders of Overstock.com, Inc. \$161,624

Equity attributable to noncontrolling interests

Balance at beginning of period

\$(1,092 )

Net loss attributable to noncontrolling interests

(940 )

Total equity attributable to noncontrolling interests

\$(2,032 )

Total equity

\$159,592



See accompanying notes to unaudited consolidated financial statements.

6

---

Table of Contents

Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Nine months ended September 30,		Twelve months ended September 30,	
	2016	2015	2016	2015
Cash flows from operating activities:				
Consolidated net income	\$8,487	\$1,357	\$8,350	\$2,662
Adjustments to reconcile net income to net cash (used in) provided by operating activities:				
Depreciation of fixed assets	19,710	17,384	26,729	22,522
Amortization of intangible assets	3,193	443	3,444	563
Stock-based compensation to employees and directors	4,105	2,577	5,054	3,663
Deferred income taxes, net	6,688	3,470	4,701	4,302
Amortization of debt issuance costs	—	21	—	21
Loss on investment in precious metals	—	662	521	1,179
Loss on investment in cryptocurrency	—	147	5	147
Impairment of cost method investment	2,850	—	2,850	—
Ineffective portion of loss on cash flow hedge	—	124	—	124
Termination costs of cryptobond financing	—	—	850	—
Other	207	9	207	(38 )
Changes in operating assets and liabilities, net of acquisitions:				
Restricted cash	—	—	—	1,000
Accounts receivable, net	(2,909 )	2,662	(2,108 )	(1,360 )
Inventories, net	4,325	3,002	7,489	2,077
Prepaid inventories, net	(226 )	1,936	(259 )	445
Prepays and other current assets	(3,456 )	(3,782 )	(1,012 )	(1,753 )
Other long-term assets, net	(356 )	380	(670 )	413
Accounts payable	(40,247 )	(47,313 )	17,548	1,851
Accrued liabilities	(8,678 )	(17,751 )	4,920	1,020
Deferred revenue	(9,687 )	(3,298 )	(3,896 )	4,502
Other long-term liabilities	555	1,570	754	1,590
Net cash (used in) provided by operating activities	(15,439 )	(36,400 )	75,477	44,930
Cash flows from investing activities:				
Investment in precious metals	—	—	—	(2,496 )
Investment in cryptocurrency	—	—	—	96
Equity method investment	—	(152 )	—	(402 )
Disbursement of note receivable	(3,050 )	(5,000 )	(3,050 )	(5,000 )
Cost method investments	(4,000 )	(7,000 )	(4,000 )	(7,000 )
Acquisitions of businesses, net of cash acquired	1,220	(10,573 )	1,192	(10,573 )
Expenditures for fixed assets, including internal-use software and website development	(59,382 )	(43,381 )	(75,514 )	(52,183 )
Other	46	(133 )	14	(175 )
Net cash used in investing activities	(65,166 )	(66,239 )	(81,358 )	(77,733 )
Cash flows from financing activities:				
Payments on capital lease obligations	—	(362 )	—	(362 )
Paydown on direct financing arrangement	(54 )	(229 )	(134 )	(302 )
Payments on finance obligations	(1,354 )	—	(1,458 )	—

Edgar Filing: OVERSTOCK.COM, INC - Form 10-Q

Payments on interest swap	(563	) —	(620	) —
Proceeds from finance obligations	6,075	—	11,773	—
Proceeds from short-term debt	—	5,500	—	5,500
Payments on short-term debt	—	—	(750	) —
Proceeds from long-term debt	31,447	—	40,935	—
Change in restricted cash	—	75	75	75
Proceeds from exercise of stock options	—	270	—	439
Purchase of treasury stock	(737	) (2,367	) (737	) (2,367
Payment of debt issuance costs	—	(621	) —	(1,652
Net cash provided by financing activities	34,814	2,266	49,084	1,331
Net (decrease) increase in cash and cash equivalents	(45,791	) (100,373)	43,203	(31,472
Cash and cash equivalents, beginning of period	170,262	181,641	81,268	112,740
Cash and cash equivalents, end of period	\$124,471	\$81,268	\$124,471	\$81,268

Continued on the following page

Overstock.com, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(Continued)

(in thousands)

	Nine months ended		Twelve months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Supplemental disclosures of cash flow information:				
Cash paid during the period:				
Interest paid (net of amounts capitalized)	\$675	\$35	\$864	\$45
Taxes paid	1,206	272	1,207	312
Non-cash investing and financing activities:				
Fixed assets, including internal-use software and website development, costs financed through accounts payable and accrued liabilities	\$9,574	\$1,414	\$9,574	\$1,414
Equipment acquired under capital lease obligations	—	362	—	362
Capitalized interest cost	117	117	157	143
Acquisition of businesses through stock issuance	—	18,149	—	18,149
Change in value of cash flow hedge	1,780	1,684	1,361	2,692
Note receivable converted to cost method investment	2,850	—	2,850	—

See accompanying notes to unaudited consolidated financial statements.

## 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 consolidated 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, 2015. 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, 2016 are not necessarily indicative of the results to be expected for any future period or the full fiscal year.

For purposes of comparability, we reclassified certain immaterial amounts in the prior periods presented to conform with the current year presentation.

### 2. ACCOUNTING POLICIES

#### Principles of consolidation

The accompanying consolidated financial statements include our accounts and the accounts of our wholly-owned and majority-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, valuation of derivative financial instruments, revenue recognition, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets and internally-developed software, goodwill valuation, intangible asset valuation, cost method investment valuation, income taxes, stock-based compensation, performance-based compensation, and contingencies. Actual results could differ materially from these estimates.

#### Cash equivalents

We classify all highly liquid instruments, including instruments with a remaining maturity of three months or less at the time of purchase, as cash equivalents. Cash equivalents were \$45.1 million and \$28.1 million at September 30, 2016 and December 31, 2015, 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.

Fair value of financial 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, while unobservable inputs reflect our market assumptions. These two types of inputs have created the fair-value hierarchy

8

---

Table of Contents

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

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.

Under GAAP, certain assets and liabilities are required to be recorded at fair value on a recurring basis. Our assets and liabilities that are adjusted to fair value on a recurring basis are investments in money market mutual funds, trading securities, derivative instruments, and deferred compensation liabilities.

The fair values of our investments in money market mutual funds, trading securities, and deferred compensation liabilities are determined using quoted market prices from daily exchange traded markets on the closing price as of the balance sheet date and are classified as Level 1.

The fair values of our derivative instruments are determined using standard valuation models. The significant inputs used in these models are readily available in public markets, or can be derived from observable market transactions, and therefore have been classified as Level 2. Inputs used in these standard valuation models for derivative instruments include the applicable forward rates, interest rates and discount rates. Included in the fair value of derivative instruments is an adjustment for nonperformance risk. The adjustment for nonperformance risk did not have a significant impact on the estimated fair value of our derivative instruments. For additional disclosures related to our derivative instruments, see Derivative financial instruments below.

The following tables summarize our assets and liabilities measured at fair value on a recurring basis using the following levels of inputs as of September 30, 2016 and December 31, 2015 as indicated (in thousands):

	Fair Value Measurements at September 30, 2016:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 45,149	\$ 45,149	\$ —	\$ —
Trading securities held in a “rabbi trust” (1)	55	55	—	—
Total assets	\$ 45,204	\$ 45,204	\$ —	\$ —
Liabilities:				
Derivatives (2)	\$ 4,256	\$ —	\$ 4,256	\$ —
Deferred compensation accrual “rabbi trust” (3)	57	57	—	—
Total liabilities	\$ 4,313	\$ 57	\$ 4,256	\$ —
	Fair Value Measurements at December 31, 2015:			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents - Money market mutual funds	\$ 28,102	\$ 28,102	\$ —	\$ —
Trading securities held in a “rabbi trust” (1)	68	68	—	—
Total assets	\$ 28,170	\$ 28,170	\$ —	\$ —
Liabilities:				
Derivatives (2)	\$ 2,356	\$ —	\$ 2,356	\$ —
Deferred compensation accrual “rabbi trust” (3)	70	70	—	—

Edgar Filing: OVERSTOCK.COM, INC - Form 10-Q

Total liabilities	\$ 2,426	\$ 70	\$ 2,356	\$ —
-------------------	----------	-------	----------	------

---

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

9

---

Table of Contents

- (2) — Derivative financial instruments are included in Other current liabilities, net and Other long-term liabilities in the consolidated balance sheets.
- (3) — Non qualified deferred compensation in a rabbi trust is included in Accrued liabilities and Other long-term liabilities in the consolidated balance sheets.

Our other financial instruments, including cash, restricted cash, accounts receivable, accounts payable, accrued liabilities, finance obligations and debt are carried at cost, which approximates their fair value.

Accounts receivable

Accounts receivable consist primarily of trade amounts due from customers in the United States 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 \$2.0 million and \$465,000 at September 30, 2016 and December 31, 2015, respectively. The increase in our allowance for doubtful accounts receivable was primarily due to an increase in our allowance for a marketplace in which we hold a minority investment (and in which we recognized an impairment charge during the three months ended September 30, 2016).

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, 2016 and December 31, 2015, 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.

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, net represent inventories paid for in advance of receipt.

Prepays and other current assets



Prepays and other current assets represent expenses paid prior to receipt of the related goods or services, including advertising, license fees, maintenance, packaging, insurance, and other miscellaneous costs.

Table of Contents

## Fixed assets

During Q3 2016, we substantially completed the construction of a new corporate headquarters and we placed the related fixed assets in service during the period. These assets include the building, land improvements, building machinery and equipment, and additional furniture and equipment. Our fixed assets, which also include technology infrastructure, internal-use software, website development 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. During Q3 2016, we changed the estimated useful life of our furniture and equipment from 3-5 years to 5-7 years, due primarily to our acquisition of longer lived furniture and equipment for our new headquarters. This change in estimate will be applied prospectively. We do not expect this change in estimate to have a material impact on our financial statements. Substantially all of the furniture and equipment from our previous headquarters was fully depreciated. The estimated useful lives of our fixed assets are as follows:

	Life (years)
Building	40
Land improvements	20
Building machinery and equipment	15-20
Furniture and equipment	5-7
Computer hardware	3-4
Computer software	2-4

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

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Cost of goods sold - direct	\$77	\$73	\$235	\$206
Technology	6,952	5,875	18,755	16,331
Marketing	29	—	29	—
General and administrative	357	284	691	847
Total depreciation, including internal-use software and website development	\$7,415	\$6,232	\$19,710	\$17,384

Total accumulated depreciation of fixed assets was \$174.3 million and \$156.8 million at September 30, 2016 and December 31, 2015, respectively.

## Capitalized interest

We capitalize interest costs incurred on debt during the construction of major projects. Capitalized interest for the three and nine months ended September 30, 2016 and 2015 was immaterial.

## 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, 2016 and 2015, we capitalized \$3.2 million and \$4.4 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 \$5.0 million and \$3.9 million, respectively, for those respective periods. During the nine months ended September 30, 2016 and 2015, we capitalized

11

---

## Table of Contents

\$13.3 million and \$13.8 million, respectively, of such costs and had amortization of \$12.7 million and \$10.8 million for those respective periods.

### Cost method investments

At September 30, 2016, we held minority interests (less than 20%) in five privately held entities. The total aggregate amount of these investments was approximately \$13.9 million. For one of our investments we agreed to make a subsequent \$3.0 million investment, and a \$3.0 million loan, that are contingent on the investee reaching certain milestones. We do not know when, or if, the investee will reach such milestones. We did not acquire a controlling interest in this investee, nor would our interest become controlling if we were to make the subsequent investment. Based on the nature of our investment, we have a variable interest in this investee. However, because we do not have power to direct the investee's activities, and therefore we are not the investee's primary beneficiary, we do not consolidate the investee in our financial statements. In June 2016, in order to maintain our proportional interest, we made a \$200,000 convertible loan to an investee. The loan will convert to an equity interest no later than January 2018.

These investments are recognized as cost method investments included in Other long-term assets, net in our consolidated balance sheets. Earnings from the investments are recognized to the extent of dividends received, and we will recognize subsequent impairments to the investment if they are other than temporary. We review these investments individually for impairment by evaluating if events or circumstances have occurred that may have a significant adverse effect on their fair value. If such events or circumstances have occurred, we will estimate the fair value of the investment and determine if any decline in the fair value of the investment below its carrying value is other-than-temporary. In such cases, the estimated fair value of the investment is determined using unobservable inputs including assumptions by the investee's management. These inputs are classified as Level 3. See Fair value of financial instruments above.

At September 30, 2016, the carrying amount of our cost method investments was \$11.0 million. We recognized a \$2.9 million impairment loss during the three and nine months ended September 30, 2016, which consisted of the entire carrying amount of the related investment. The impairment loss was recorded in other income, net on the consolidated statements of operations. We recognized no impairment losses during the year ended 2015.

### Noncontrolling interests

During 2014, we formed tØ.com, Inc. (formerly Medici, Inc.) to develop blockchain and fintech technology as part of our Medici initiatives. tØ.com is a majority owned subsidiary of Overstock. During Q1 2016, tØ.com completed the acquisition of a financial technology firm and two registered broker dealers, each of which was under common control with the firm from which the financial technology assets were purchased. The former owners of that firm hold noncontrolling interests in tØ.com. These transactions are described further in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. The proceeds for the acquisitions were financed by tØ.com through a note payable to Overstock that bears interest at a rate that approximates the Federal Funds Rate. tØ.com is included in our consolidated financial statements. Intercompany transactions have been eliminated and the amounts of contributions and gains or losses that are attributable to the noncontrolling interests are disclosed in our consolidated financial statements.

### 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.

#### Precious metals

12

---

## Table of Contents

Our precious metals consisted of \$5.7 million in gold and \$4.0 million in silver at September 30, 2016 and December 31, 2015. We store our precious metals at an off-site secure facility. Because these assets consist of actual precious metals, rather than financial instruments, we account for them as an investment initially recorded at cost (including transaction fees) and then adjusted to the lower of cost or 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 operations. There were no recorded gains or losses on investments in precious metals for the three and nine months ended September 30, 2016. We recorded a \$610,000 and \$662,000 loss on investments in precious metals for the three and nine months ended September 30, 2015.

## Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the 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 annually or when we deem that a triggering event has occurred. There were no impairments to goodwill recorded during the nine months ended September 30, 2016 or the year ended December 31, 2015.

During the nine months ended September 30, 2016, we recognized a \$689,000 adjustment in goodwill related to a business combination as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. The change in goodwill relates to a non-reportable segment, included in Other as described in Note 8—Business Segments.

## Intangible assets other than goodwill

We capitalize and amortize intangible assets other than goodwill over their estimated useful lives unless such lives are indefinite. Intangible assets other than goodwill acquired separately from third-parties are capitalized at cost while such assets acquired as part of a business combination are capitalized at their acquisition-date fair value. Intangible assets other than goodwill are amortized using the straight line method of amortization over their useful lives, with the exception of certain intangibles (such as acquired technology, customer relationships, and trade names) which are amortized using an accelerated method of amortization based on cash flows. These assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable as described below under Impairment of long-lived assets.

During the nine months ended September 30, 2016, we acquired \$224,000 of intangible assets other than goodwill related to a business combination as described in Note 3—Acquisitions, Goodwill, and Acquired Intangible Assets. Aggregate amortization expense for acquired intangible assets other than goodwill was \$1.0 million and \$354,000 for the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016

and 2015, the aggregate amortization expense for intangible assets other than goodwill was \$3.2 million and \$443,000, respectively.

#### Impairment of long-lived assets

We review property and equipment and other long-lived assets, including intangible assets other than goodwill, 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

## Table of Contents

amount of the assets exceeds their fair values. There were no impairments to long-lived assets recorded during the nine months ended September 30, 2016 or the year ended December 31, 2015.

### Cryptocurrency holdings

We hold cryptocurrency-denominated assets such as bitcoin and we include them in prepaids and other current assets in our consolidated balance sheets. Cryptocurrency-denominated assets were \$288,000 and \$226,000 at September 30, 2016 and December 31, 2015, respectively, and are recorded at the lower of cost or 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 cryptocurrency assets are recorded in Other income, net in our consolidated statements of operations. There were no recorded gains or losses on cryptocurrency holdings during the nine months ended September 30, 2016. Losses on cryptocurrency holdings were \$147,000 during the nine months ended September 30, 2015.

### Other long-term assets, net

Other long-term assets consist primarily of cost and equity method investments (see Cost method investments above) and long-term prepaid expenses.

### Derivative financial instruments

In 2014, we entered into a loan agreement in connection with the construction of our new corporate headquarters. We began borrowing under the facility in October 2015. Because amounts borrowed on the loan will carry a variable LIBOR-based interest rate, we will be affected by changes in certain market conditions. These changes in market conditions may adversely impact our financial performance, and as such, we use derivatives as a risk management tool to mitigate the potential impact of these changes. We do not enter into derivatives for speculative or trading purposes. The primary market risk we manage through the use of derivative instruments is interest rate risk on the amounts we have borrowed under the loan agreement relating to our new headquarters. To manage that risk, we use interest rate swap agreements. An interest rate swap agreement is a contract between two parties to exchange cash flows based on underlying notional amounts and indices. Our interest rate swaps entitle us to pay amounts based on a fixed rate in exchange for receipt of amounts based on variable rates over the term of the related loan agreement. The notional amounts under our hedges were \$45.1 million and \$20.5 million at September 30, 2016 and December 31, 2015, respectively.

Our derivatives are carried at fair value in our consolidated balance sheets in Other current liabilities, net and Other long-term liabilities on a gross basis. The accounting for gains and losses that result from changes in the fair values of derivative instruments depends on whether the derivatives have been designated and qualify as hedging instruments under GAAP. Our derivatives have been designated and qualify as cash flow hedges. We formally designated and documented, at inception, the financial instruments as hedges of specific underlying exposures, the risk management objectives, and the strategy for undertaking the hedging transactions. In addition, we formally assess, both at the inception and at least quarterly thereafter, whether the financial instruments used in hedging transactions are effective at offsetting changes in the cash flows of the related underlying exposures. To the extent that the hedges are effective, the changes in fair values of our cash flow hedges are recorded in Accumulated other comprehensive income (loss) in the consolidated statements of changes in stockholders' equity. Any ineffective portion is immediately recognized into earnings. The variable-rate interest on the borrowing for our new corporate headquarters was capitalized during the construction period. The amounts in Accumulated other comprehensive income (loss) related to the cash flow hedge of the variability of the interest that was capitalized is reclassified into earnings over the depreciable life of the asset.



During the three and nine months ended September 30, 2015, the amount of gains or losses in accumulated other comprehensive income that has been reclassified into earnings was not material and the amounts at September 30, 2016 that we will reclassify into earnings within the next 12 months is not expected to be material.

We determine the fair values of our derivatives based on quoted market prices or using standard valuation models (see Fair value of financial instruments above). The notional amounts of the derivative financial instruments do not necessarily represent amounts exchanged by the parties and, therefore, are not a direct measure of our exposure to the financial risks described above. The amounts exchanged are calculated by reference to the notional amounts and by other terms of the derivatives, such as interest rates.

Table of Contents

The following table shows the effect of derivative financial instruments that were designated as accounting hedges for the period indicated (in thousands):

Cash flow hedges	Amount of gain (loss) recognized in OCI on derivative (effective portion) net of tax	Location of gain (loss) reclassified from Accumulated OCI into operations (effective portion)	Amount of gain (loss) reclassified from Accumulated OCI into operations (effective portion)	Location of gain (loss) recognized in operations on derivative (ineffective portion)	Amount of gain (loss) recognized in operations on derivative (ineffective portion)
Three months ended September 30, 2016					
Interest rate swap	\$ (64 )	Interest expense	\$ 1	Other income (expense)	\$ —
Nine months ended September 30, 2016					
Interest rate swap	\$ (1,624 )	Interest expense	\$ 1	Other income (expense)	\$ —

The following table provides the outstanding notional balances and fair values of derivative financial instruments that were designated as accounting hedges outstanding positions for the dates indicated, and recorded gains/(losses) during the periods indicated (in thousands):

Cash flow hedges	Location in balance sheet	Expiration date	Outstanding notional	Fair value	Beginning gains (losses)	Gains (losses) recorded during period (1)	Ending gains (losses)
Three months ended September 30, 2016							
Interest rate swap	Current and Other long-term liabilities	2023	\$ 45,054	\$(4,256)	\$(4,683 )	\$427	\$(4,256)
Nine months ended September 30, 2016							
Interest rate swap	Current and Other long-term liabilities	2023	\$ 45,054	\$(4,256)	\$(2,397 )	\$(1,859 )	\$(4,256)

(1) — Gains (losses) recorded during the period are presented gross of the related tax impact.

## Revenue recognition

We derive our revenue primarily from direct revenue and partner revenue from merchandise sales. We also earn revenue from advertising on our website and from other pages. We have organized our operations into two principal reporting segments based on the primary source of revenue: direct revenue and 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, those warehouses we control, or those of our partners); (iii) the delivery destination; and (iv) actual transit time experience, which shows that delivery date is typically one to eight business days from the date of shipment. We review and update our estimates on a quarterly basis based on our actual transit time experience. However, actual shipping times may differ from our estimates.

## Table of Contents

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 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.

We evaluate the revenue recognition criteria above for our broker-dealer subsidiaries (see Note 9 - Broker Dealers) and we recognize securities transactions (and the related commission revenue) on a trade date and gross basis.

### Direct revenue

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

### Partner and other revenue

Partner and other revenue is derived primarily from merchandise sales of inventory owned by our partners which they generally ship directly to our consumers and businesses. Partner and other revenue comes from merchandise sales that occur primarily through our Website, but may also occur through offline and other channels.

### Club O loyalty program

We have a customer loyalty program called Club O Gold for which we sell annual memberships. For Club O Gold memberships, we record membership fees as deferred revenue and we recognize revenue ratably over the membership period. The Club O Gold loyalty program allows members to earn Club O Reward dollars for qualifying purchases made on our Website. We also have a co-branded credit card program (see Co-branded credit card program below for more information). Co-branded cardholders are also Club O Gold members and earn additional reward dollars for purchases made on our Website, and from other merchants.

Beginning in 2015, we enrolled a significant number of members in Club O Silver, a newly introduced Club O membership tier for customers who agree to receive promotional emails. Club O Silver members earned Club O Rewards on qualifying purchases that expire after 90 days from a qualifying purchase. We discontinued Club O Silver in October 2016. Since the program's introduction, the growth in Club O Silver caused increases in reward dollars earned and resulting breakage. The increases in reward breakage attributable to Club O Silver may continue as compared to prior periods for several months until all remaining Club O Silver rewards have expired.

Earned Club O Reward dollars may be redeemed on future purchases made through our Website. We recognize revenue for Club O Reward dollars when customers redeem their reward dollars as part of a purchase on our Website. 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. Club O Gold membership reward dollars expire 90 days after the customer's Club O Gold membership expires. When Club O Reward dollars expire, we recognize reward dollar

breakage as Other income, net in our consolidated statements of operations.

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

16

---

## Table of Contents

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 estimated expected life of co-branded credit card customers. Credit card usage fees are recognized as revenues as actual credit card usage occurs.

We also have a private label credit card agreement with another commercial bank for the issuance of credit cards bearing our brand, but that is only available for use on our Website. In connection with the agreement, we received upfront fees that we recognize as revenue on a straight line basis over the term of the agreement, which runs through February 2022. When customers make regular revolving purchases using the card, we receive fees, which are recognized as revenue. When we offer promotional financing for purchases made with the card (for example, 12 months same as cash), we pay a discount fee to the commercial bank, which we recognize as a reduction of revenue. The commercial bank owns all of the accounts under the program and performs all account administration, underwriting and servicing. Fees and royalties from new accounts, credit card usage fees, and fees from both of these cards 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 Gold 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.

We periodically enter into agreements with other parties to jointly market ancillary products or services on our website. As a result of those agreements, we sometimes receive payments in advance of performing our obligations under those agreements. Such payments received before we perform our obligations are initially recorded as deferred revenue and then recognized over our service period.

### 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 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.

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 \$12.8 million and \$17.9 million at September 30, 2016 and December 31, 2015 respectively.

Table of Contents

## 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 \$327,000 and \$240,000 at September 30, 2016 and December 31, 2015, 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				Nine months ended			
	September 30,		September 30,		September 30,		September 30,	
	2016	2015	2016	2015	2016	2015	2016	2015
Total revenue, net	\$441,564	100 %	\$391,211	100 %	\$1,273,781	100 %	\$1,177,568	100 %
Cost of goods sold								
Product costs and other cost of goods sold	343,401	78 %	301,164	77 %	985,603	77 %	903,720	77 %
Fulfillment and related costs	18,447	4 %	17,596	4 %	54,833	4 %	52,303	4 %
Total cost of goods sold	361,848	82 %	318,760	81 %	1,040,436	82 %	956,023	81 %
Gross profit	\$79,716	18 %	\$72,451	19 %	\$233,345	18 %	\$221,545	19 %

## 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 \$31.5 million and \$27.7 million during the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, advertising expenses totaled \$90.6 million and \$79.5 million, respectively. Prepaid advertising (included in Prepaids and other current assets in the accompanying consolidated balance sheets) was \$1.9 million and \$1.2 million at September 30, 2016 and December 31, 2015, respectively.

## Stock-based compensation

We measure compensation expense for all outstanding unvested share-based awards at fair value on the date of grant and recognize compensation expense over the service period for awards expected to vest at the greater of a straight line basis or on an accelerated schedule when vesting of restricted stock awards exceeds 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 are recorded as an adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, and historical experience. Actual results may differ substantially from these estimates (see Note 7—Stock-Based Awards).

## Loss contingencies



In the normal course of business, we are involved in legal proceedings and other potential loss contingencies. We accrue a liability for such matters when it is probable that a loss has been incurred and the amount can be reasonably estimated. When only a range of 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 (see Note 5—Commitments and Contingencies).

Income taxes

18

---

## Table of Contents

Our income tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, for relevant interim periods. We update our estimate of the annual effective tax rate each quarter and make cumulative adjustments if our estimated annual effective tax rate changes.

Our quarterly tax provision and our quarterly estimate of our annual effective tax rate are subject to significant variations due to several factors including variability in predicting our pre-tax and taxable income and the mix of jurisdictions to which those items relate, relative changes of expenses or losses for which tax benefits are not recognized, how we do business, and changes in law, regulations, and administrative practices. Our effective tax rate can be volatile based on the amount of pre-tax income. For example, the impact of discrete items on our effective tax rate is greater when pre-tax income is lower.

We assess the available positive and negative evidence to estimate whether we will generate sufficient future taxable income to use our existing deferred tax assets. We consider, among other things, our recent historical financial and operating results (three years of cumulative income and revenue growth during those periods), along with our forecasted growth rates, projected future taxable income, including the impact of any costs associated with our recent acquisition, and tax planning strategies. We perform multiple sensitivity analyses to address how potential changes in significant assumptions would impact our ability to generate the minimum amount of taxable income required. We give the most weight to objective evidence related to our more recent financial results. Based upon the level of historical taxable income and projections for future taxable income, including the impact of any acquisition costs, and planned tax strategies over the periods in which the deferred tax assets are deductible, we believe it is more likely than not that we will realize the benefits of these deduction differences, net of existing valuation allowances. However, it is possible that certain state tax credits could ultimately expire unused if estimates of future apportioned taxable income during the carryforward period are reduced.

We have not provided for U.S. income tax on certain foreign earnings because we intend to indefinitely reinvest these earnings outside the U.S. We have begun expansion of operations outside of the U.S. and have plans for additional expansion for which we have incurred and will continue to incur capital requirements. We have considered ongoing capital requirements of the parent company in the U.S.

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. Under this approach, excess tax benefits related to stock-based compensation are the last tax benefits 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.

Table of Contents

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, 2016		2015		Nine months ended September 30, 2016		2015	
Net income (loss) attributable to stockholders of Overstock.com, Inc.	\$(3,098)	\$(2,071)	\$9,427	\$2,336				
Net income (loss) per common share—basic:								
Net income (loss) attributable to common shares—basic	\$(0.12 )	\$(0.08 )	\$0.37	\$0.10				
Weighted average common shares outstanding—basic	25,356	24,681	25,326	24,402				
Effect of dilutive securities:								
Stock options and restricted stock awards	—	—	62	111				
Weighted average common shares outstanding—diluted	25,356	24,681	25,388	24,513				
Net income (loss) attributable to common shares—diluted	\$(0.12 )	\$(0.08 )	\$0.37	\$0.10				

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, 2016		Nine months ended September 30, 2015	
Stock options and restricted stock units	765	566	536	262

## Stock repurchase program

On May 5, 2015, our Board of Directors authorized a stock repurchase program under which we may repurchase shares of our outstanding common stock for up to \$25 million at any time through December 31, 2017. To date, we have not made any repurchases under this program.

## Recently adopted accounting standards

In April 2015, the FASB issued ASU No. 2015-03, Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We implemented the provisions of ASU 2015-03 on January 1, 2016. The prior period amounts related to this implementation have been reclassified to conform to the current period presentation and were not significant. The implementation of ASU 2015-03 did not impact our results of operations or cash flows.

## Recently issued accounting standards not yet adopted

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date for us of ASU No. 2014-09 to January 1, 2018. Early adoption of ASU No. 2014-09 is permitted, but not before its original effective date. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers - Principal versus Agent Considerations. This ASU

clarifies the implementation guidance for principal versus agent considerations in ASU No. 2014-09 and provides indicators that assist in the assessment of control. ASU No. 2016-08 is effective for us beginning January 1, 2018. In 2016, the FASB issued additional implementation guidance for the new revenue recognition standards. These standards permit the use of either the retrospective or cumulative effect transition method. We have initiated an assessment of our revenue streams and have developed an initial plan for implementing these standards. We have not yet selected a transition method nor have we completed our assessment of the effect that ASU No. 2014-09 will have on our consolidated financial statements and related disclosures.

Table of Contents

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which requires inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard requires entities to apply this change prospectively to the measurement of inventory after the date of adoption. We do not intend to adopt the standard before the effective date and we do not expect that ASU No. 2015-11 will have a significant impact on our consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, which requires that deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard requires entities to apply this change on either a prospective or retrospective basis for the periods presented. We do not intend to adopt the standard before the effective date and we expect to apply the standard prospectively. The adoption of this standard will cause us to reclassify our current deferred tax assets and liabilities to a single noncurrent amount in our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which, among other things, requires lessees to recognize most leases on their balance sheets related to the rights and obligations created by those leases. The new standard also requires new disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The new standard becomes effective for us on January 1, 2019. Early adoption is permitted. The amendments in this update should be applied under a modified retrospective approach. We are evaluating the effect that ASU No. 2016-02 will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-04, Liabilities - Extinguishment of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products, which specifies how prepaid stored-value product liabilities, such as gift cards, should be derecognized. The standard, among other things, requires derecognition of such liabilities through expected breakage in proportion to the pattern of rights expected to be exercised by the holder, but only to the extent that it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. The new standard becomes effective for us on January 1, 2018. Early adoption is permitted. The amendments in this update should be applied under a modified retrospective approach or a retrospective approach to each period presented. We are evaluating the effect that ASU No. 2016-04 will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-07, Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting, which eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by step basis as if the equity method had been in effect during all previous periods that the investment had been held. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard requires entities to apply this change prospectively. We do not expect that ASU No. 2016-07 will have a material impact on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard becomes effective for us on January 1, 2017. Early adoption is permitted. The standard specifies various transition methods for the individual amendments in this Update. The adoption of this standard will primarily cause us to recognize additional deferred tax assets related to excess tax

benefits through a cumulative effect adjustment in retained earnings as of January 1, 2017. We are evaluating the effect that ASU No. 2016-09 will have on our consolidated financial statements and related disclosures.

### 3. ACQUISITIONS, GOODWILL, AND ACQUIRED INTANGIBLE ASSETS

As part of our Medici blockchain and fintech technology initiatives, during 2015, a subsidiary of tØ.com, Inc. (formerly Medici, Inc.) entered into a purchase agreement to acquire Cirrus Technologies LLC, a financial technology firm. In connection with the Cirrus Technology acquisition, a subsidiary of tØ.com also entered into an agreement to purchase SpeedRoute LLC and all of the outstanding membership interests not already owned by tØ.com in Pro Securities, LLC. Both SpeedRoute and Pro Securities were under common control with Cirrus Technologies by a party that holds a noncontrolling

Table of Contents

interest in tØ.com. SpeedRoute and Pro Securities are FINRA-registered broker dealers.

This acquisition closed in two parts. The Cirrus Technologies acquisition closed in Q3 2015 and the membership interests in SpeedRoute and Pro Securities closed in Q1 2016 after receiving approval from FINRA. The total gross purchase price of this acquisition was \$29.7 million, consisting of approximately \$11.6 million in cash (which excludes \$2.2 million in cash acquired, primarily during Q1 2016) and 908,364 shares of Overstock's common stock valued at approximately \$18.1 million. The proceeds for the acquisition were financed by tØ.com through a note payable to Overstock that bears interest that approximates the Federal Funds Rate. The total purchase price has been allocated to the assets acquired and the liabilities assumed based on their respective fair values at the acquisition dates, with amounts exceeding fair value recorded as goodwill. We did not record significant deferred taxes related to the acquisition. The goodwill of the acquired business is deductible for tax purposes.

The acquisition of Cirrus Technologies and the acquisition of the membership interests of SpeedRoute and Pro Securities were negotiated and contemplated in conjunction with each other. As such, this was recognized as a single transaction. We estimated the fair value of the acquired assets based on Level 3 inputs, which were unobservable (see Note 2—Accounting Policies, Fair value of financial instruments). These inputs included our estimate of future revenues, operating margins, discount rates, royalty rates and assumptions about the relative competitive environment.

The fair values of the assets acquired and liabilities assumed at the acquisition dates are as follows (in thousands):

Purchase Price	Fair Value
Cash paid, net of cash acquired	\$9,353
Common stock issued	18,149
	\$27,502
Allocation	
Goodwill	\$11,914
Intangibles	16,000
Accounts receivable and other assets	2,565
Other liabilities assumed	(2,977 )
	\$27,502

The following table details the identifiable intangible assets acquired at their fair value and useful lives (amounts in thousands):

Intangible Assets	Fair Value	Weighted Average Useful Life (years)
Technology and developed software	\$13,600	8.21
Customer relationships	1,900	4.83
Trade names	300	0.12
Other	200	
Total acquired intangible assets at the acquisition dates	16,000	
Less: accumulated amortization of acquired intangible assets	(4,599 )	
Total acquired intangible assets, net as of September 30, 2016	\$11,401	

The expense for amortizing acquired intangible assets in connection with this acquisition was \$1.0 million and \$3.2 million for the three and nine months ended September 30, 2016, respectively.

Acquired intangible assets primarily include technology, customer relationships and trade names. As described above, we determined the fair value of these assets using an income approach method to determine the present value of expected future cash flows for each identifiable intangible asset. This method was based on discount rates which

incorporate a risk premium to take into account the risks inherent in those expected cash flows. The expected cash flows were estimated using the expectations of market participants.

As a result of the closing of the membership interests in SpeedRoute and Pro Securities, and finalizing the valuation of the acquired assets, during the nine months ended September 30, 2016, we made a \$689,000 adjustment in goodwill consisting

22

---



Table of Contents

primarily of net cash acquired of \$1.2 million, accounts receivable and other assets of \$1.9 million and liabilities assumed of \$2.5 million.

The acquired assets, liabilities, and associated operating results were consolidated into our financial statements at the acquisition dates, or the dates on which we obtained control of the acquired assets or interests. The revenue and operating loss of the combined acquired entities included in our financial statements were \$3.9 million and \$3.0 million, respectively, for the three months ended September 30, 2016, and were \$10.5 million and \$9.2 million, respectively, for the nine months ended September 30, 2016.

The following unaudited pro forma financial information presents our results as if the acquisitions had occurred at the beginning of 2015 (amounts in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net revenues	\$441,564	\$397,339	\$1,274,957	\$1,181,270
Operating income (loss)	\$(5,047 )	\$(3,173 )	\$7,484	\$3,208

The unaudited pro forma financial information is not intended to represent or be indicative of our consolidated results of operations that would have been reported had the acquisition been completed during the periods indicated, nor should it be taken as indicative of our future consolidated results of operations.

#### 4. BORROWINGS

##### U.S. Bank term loan and revolving loan agreement

In October 2014, we entered into a syndicated senior secured credit facility (the "Facility") with U.S. Bank National Association ("U.S. Bank" or the "Administrative Bank") and certain other banks in connection with the construction of our new corporate headquarters (the "Project"). The Facility is governed by a Loan Agreement dated as of October 24, 2014 which provides for an aggregate credit amount of \$55.8 million, consisting of (i) a senior secured real estate loan of \$45.8 million (the "Real Estate Loan") to be used to finance a portion of the Project and (ii) a three-year \$10.0 million senior secured revolving credit facility (the "Revolving Loan") for working capital and capital expenditures, but not for the Project. The Real Estate Loan and the Revolving Loan are both secured by the Project, our inventory and accounts receivable, substantially all of our deposit accounts and related assets. We began borrowing under the facility in October 2015.

On or about January 1, 2017 (but no later than 90 days thereafter), the Real Estate Loan is designed to convert into an approximately 6.75-year term loan due October 1, 2023 (the "Term Loan"). The conditions to conversion of the Real Estate Loan to the Term Loan include, among others, requirements that the Project must have been completed in accordance with the applicable plans, paid for in full, and generally free of liens; completion must have been certified by the project architect and the inspecting architect; certificates of occupancy must have been issued; we must have paid all amounts then due to the lending banks and must be in compliance with the covenants under the Loan Agreement; the Real Estate Loan must be brought "in balance" as defined in the Loan Agreement, which may require us to contribute additional cash to the Project; we must have paid the final amount of our cash contribution as required by the Loan Agreement; and if required by the Administrative Bank, an updated appraisal must show that the Project is in compliance with an 80% loan to value ratio requirement. If the conditions to conversion are not satisfied, all amounts outstanding under the Facility will become immediately due and payable. In August 2016, the Project was substantially completed, we obtained a temporary certificate of occupancy and we began to occupy the building. We anticipate the Real Estate Loan to convert to the Term Loan on January 1, 2017 (but no later than 90 days thereafter).

Amounts outstanding under the Real Estate Loan and the Term Loan carry an interest rate based on one-month LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%. However, we have entered into interest rate swap agreements designed to fix our interest rate on the Real Estate Loan and the Term Loan at approximately 4.6% annually (see Derivative financial instruments in Note 2. Accounting Policies). Monthly payments of interest only will be due and payable on the Real Estate Loan prior to conversion. Following conversion, we are required to make monthly payments of principal estimated to be \$1.1 million annually plus interest, with a balloon payment of all unpaid principal (estimated to be \$38.0 million) and interest on

Table of Contents

October 1, 2023. Amounts outstanding under the Revolving Loan will carry an interest rate based on LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%.

We are required to maintain compliance as of the end of each calendar quarter with the following financial covenants:

- a fixed charge coverage ratio on a trailing 12-month basis of no less than 1.15 to 1.00;
- a cash flow leverage ratio on a trailing 12-month basis not greater than 3.00 to 1.00 during the Construction Phase (as defined in the Loan Agreement);
- a cash flow leverage ratio not greater than 2.50 to 1.00 following the Construction Phase; and
- minimum liquidity of at least \$50.0 million.

At September 30, 2016, we were in compliance with the financial covenants. In addition to the financial covenants described above, we are required to comply with a number of covenants relating to the Project and our business, including covenants limiting certain indebtedness. Notwithstanding, the Loan Agreement permits us to incur up to \$20.0 million of additional senior-secured indebtedness for equipment financing (as described under U.S. Bank master lease agreement below),

and other senior-secured indebtedness provided that the aggregate principal amount of such other senior-secured indebtedness does not exceed ten percent of our consolidated assets. The Loan Agreement includes customary events of default in addition to events of default relating specifically to the Project. The Real Estate Loan and the Revolving Loan are cross-defaulted and cross-collateralized. In the event of a default, the default rate of interest would be 2.00% above the otherwise applicable rate. Unless it terminates earlier or is extended with the consent of the Administrative Bank and all of the Banks, the Revolving Loan facility will terminate on October 24, 2017.

As of September 30, 2016, we had borrowed \$40.9 million under the Real Estate Loan. We have not borrowed any amounts under the Revolving Loan. Our liability under the Real Estate Loan approximates fair value. Amounts outstanding under the Real Estate Loan are presented net of discount and issuance costs in our consolidated balance sheets.

Future principal payments on the Facility as of September 30, 2016, are as follows (in thousands):

Payments due by period:

2016 (Remainder)	\$—
2017	1,145
2018	1,145
2019	1,145
2020	1,145
Thereafter	36,355
	\$40,935

U.S. Bank master lease agreement

In November 2015, we entered into a Master Lease Agreement and a Financial Covenants Rider (collectively, the “Master Lease Agreement”) with U.S. Bank Equipment Finance, a division of U.S. Bank National Association (“Lessor”). Under the Master Lease Agreement we are able to sell certain assets (the “Leased Assets”) to the Lessor and simultaneously lease them back for a period of 60 months. We are also able to finance certain software licenses (inclusive in the “Leased Assets”) for a period of 60 months. We have the right to repurchase the Leased Assets and terminate the Master Lease Agreement twelve months following the initial term. We also have the right to repurchase the Leased Assets at the end of the term for \$1.00. Payments on the Master Lease Agreement are due monthly. During the nine months ended September 30, 2016, we received proceeds under the Master Lease Agreement of \$6.1 million. At September 30, 2016, our total outstanding liability under the Master Lease Agreement was \$10.3 million. The

average interest rate for amounts outstanding under the Master Lease agreement was approximately 3.50%.

We have accounted for the Master Lease Agreement as a financing transaction and amounts owed are included in Finance obligations, current and non-current in the consolidated balance sheets. We recorded no gain or loss as a result of this transaction. The Master Lease Agreement allows for lease financing of up to \$20 million. Our liability under the Master Lease Agreement approximates fair value.

Table of Contents

In connection with the Master Lease Agreement, and as long as any obligations remain outstanding under the Master Lease Agreement, we are required to maintain compliance with the same financial covenants as the Term Loan agreement with U.S. Bank described above. At September 30, 2016, we were in compliance with these financial covenants.

Future principal payments of finance obligations as of September 30, 2016, are as follows (in thousands):

Payments due by period:

2016 (Remainder)	\$553
2017	2,260
2018	2,339
2019	2,419
2020	2,399
Thereafter	345
	\$10,315

#### U.S. Bank letters of credit

At September 30, 2016 and December 31, 2015, letters of credit totaling \$430,000 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, 2016, \$636,000 was outstanding and \$4.4 million was available under the Purchasing Card. At December 31, 2015, \$641,000 was outstanding and \$4.4 million was available under the Purchasing Card.

#### Capital leases

Fixed assets included assets under capital leases and finance obligations of \$16.2 million and \$10.0 million, at September 30, 2016 and December 31, 2015, respectively. Accumulated depreciation related to assets under capital leases and finance obligations was \$7.2 million and \$4.6 million, at September 30, 2016 and December 31, 2015, respectively.

Depreciation expense of assets recorded under capital leases was \$948,000 and \$218,000 for the three months ended September 30, 2016 and 2015, respectively, and \$2.4 million and \$632,000, for the nine months ended September 30, 2016 and 2015, 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, 2016, are as follows (in thousands):

Payments due by period

2016 (Remainder)	\$2,479
2017	8,592
2018	6,359
2019	5,822

2020	4,038
Thereafter	24,513
	\$51,803

25

---

## Table of Contents

Rental expense for operating leases totaled \$3.3 million and \$3.1 million for the three months ended September 30, 2016 and 2015, respectively, and \$10.1 million and \$9.4 million for the nine months ended September 30, 2016 and 2015, respectively.

## Legal Proceedings and Contingencies

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 if 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 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, and we have tendered defense of the case to an indemnitor who accepted the defense. On April 21, 2016, the court entered an order partially dismissing the claims against us. On May 4, 2016, the plaintiff filed an amended complaint, and in response, we have filed a motion requesting the court to dismiss the remaining claims against us. 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 an adversary proceeding against us 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 case is in its discovery stages. Both parties have filed motions for summary judgment and are waiting for the court to hear the motions. 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 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. The district attorneys sought 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 asked for damages in the amount of not less than \$15.0 million. We tried the case in September 2013 before the judge of the court and made final arguments in December 2013. On January 3, 2014, the court issued a tentative ruling in favor of the District Attorneys, which became a final Statement of Decision on February 5, 2014. The decision provides for an injunction that prescribes disclosures necessary for certain types of price advertising and price reductions and imposes civil penalties of \$3,500 per day for practices from March 2006 through September 2008, and \$2,000 per day for September 2008 through September 2013, totaling \$6.8 million. The court issued a final judgment February 19, 2014 reflecting the Court's Statement of Decision. We have stipulated to Plaintiff's reimbursement of costs in the amount of

\$111,500. We have appealed the decision and have secured a bond as required in the ruling in the amount of 150% of the penalty imposed in the matter until the ruling on the appeal. The appeal is briefed. No date has been set for oral argument. The nature of the loss contingencies relating to claims that have been asserted against us are described above. We intend to continue to vigorously pursue the appeal and defend this action.

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 who accepted the defense. The nature of the loss contingencies relating to claims that have been asserted against us are described above. However, no



## Table of Contents

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.

In June 2013, William French filed suit against us and 46 other defendants under seal in the Superior Court of the State of Delaware. The filing was unsealed on March 24, 2014. French brought the action on Delaware's behalf for violations of Delaware's unclaimed property laws and for recovery of the unredeemed gift card value allegedly attributable to Delaware residents. French's complaint alleges that we, and other defendants, knowingly refused to fulfill obligations under Delaware's Abandoned Property Law by failing to report and deliver unclaimed gift card funds to the State of Delaware, and knowingly made, used or caused to be made or used, false statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False Claims and Reporting Act. The complaint seeks an injunction, monetary damages (including treble damages) penalties, and attorney's fees and costs. We, along with others, filed motions to dismiss the case. The court dismissed one count, but allowed one count to remain. 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.

On September 18, 2015, we received a Tax Assessment from the Department of Revenue of the State of Washington asserting that we had nexus with Washington during the period January 1, 2008 to May 31, 2015 and assessing approximately \$31.5 million in taxes, interest, and/or penalties asserted to be due, subject to future field verification by the Department of Revenue, for the period. We recently received an additional Tax Assessment for the period of June 2015 through November 2015 in the amount of approximately \$2.5 million in taxes, interest and/or penalties. The nature of the loss contingencies relating to the assessment is described above. However, no estimate of the loss or range of loss can be made. We do not believe that we had nexus in Washington during the alleged period and, while we have engaged in some discussion with the State of Washington, we intend to vigorously contest this administrative action.

On April 28, 2016, the State of South Dakota sued us along with three other defendants in the Sixth Judicial Circuit Court of South Dakota. South Dakota alleges that U.S. constitutional law should be revised to permit South Dakota to require out-of-state ecommerce websites to withhold and remit sales tax in South Dakota. We have removed the case to the United States District Court. Pursuant to the statute, we would not be required to withhold and remit sales tax until there was verdict in favor of South Dakota which was then upheld by the highest applicable appellate court. The statute also would not require us to pay sales tax retroactively if we were to lose.

In September 2016, we received a letter from the District Attorney of Sonoma County, California who is acting as part of the Consumer Protection Divisions of the following counties in California: Sonoma, Alameda, Monterey, Napa, Solano, Fresno, Sacramento, Shasta, Santa Cruz, Butte, and Merced. The District Attorney alleges that certain plastic products on our site which are labeled as biodegradable, degradable, or decomposable constitute false advertising under California law. The District Attorney has requested documentation from us regarding this claim and we are cooperating. 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 matter and pursue our indemnification rights with our vendors.

We establish liabilities when a particular contingency is probable and estimable. At September 30, 2016, we have accrued \$9.5 million in light of 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, the environmental indemnity we entered into in favor of the lenders under our Loan Agreement with U.S. Bank and other banks, 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. During the three and nine months ended September 30, 2016, the Compensation Committee of the Board of Directors approved grants of 9,510 and 515,946 restricted stock awards, respectively, to our officers, board members and employees. The restricted stock awards vest over three years at 33.3% at the end of the first year, 33.3% at the end of the second year and 33.3% at the end of the third year and are subject to the employee's continuing service to us. At September 30, 2016, there were 560,000 unvested restricted stock awards that remained outstanding.

The cost of restricted stock awards is determined using the fair value of our common stock on the date of the grant, and compensation expense is 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 and nine months ended September 30, 2016 was \$16.63 and \$14.52, respectively.

Stock-based compensation expense related to restricted stock awards was \$1.4 million and \$839,000 during the three months ended September 30, 2016 and 2015, respectively. During the nine months ended September 30, 2016 and 2015, stock-based compensation expense related to restricted stock awards was \$4.1 million and \$2.6 million, respectively. During Q3 2016, we accelerated the vesting of certain restricted stock awards as part of employee separation agreements.

The following table summarizes restricted stock award activity during the nine months ended September 30, 2016 (in thousands):

	Nine months ended September 30, 2016	Weighted Average Grant Date Fair Value
Outstanding—beginning of year	349	\$ 24.80
Granted at fair value	516	14.52
Vested	(212)	22.60
Forfeited	(93)	16.25
Outstanding—end of period	560	\$ 17.58

## 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, which, in our view, consists primarily of our Retail and Medici businesses. Our Retail business consists of our Direct and Partner segments, and the Medici business is included in Other. Although the Direct and Partner segments both relate to our Retail business, we do not combine these segments because they have dissimilar economic characteristics, such as gross profit margins. We do not allocate operating expenses for our Direct and Partner segments below gross profit, which is the measure we use to determine our reportable segments. Because we use gross profit to determine our reportable segments, our Medici business is not

significant as compared to our other segments. We evaluate the performance of our segments and allocate resources to them based primarily on gross profit. There were no significant inter-segment sales or transfers during the three and nine months ended September 30, 2016 and 2015.

The table below summarizes information about our reportable segments for the three and nine months ended September 30, 2016 and 2015 (in thousands):

28

---

Table of Contents

	Three months ended September 30,				Nine months ended September 30,			
	Direct	Partner	Other	Total	Direct	Partner	Other	Total
2016								
Revenue, net	\$24,620	\$413,019	\$3,925	\$441,564	\$75,901	\$1,187,364	\$10,516	\$1,273,781
Cost of goods sold	23,955	335,306	2,587	361,848	72,459	961,227	6,750	1,040,436
Gross profit	\$665	\$77,713	\$1,338	\$79,716	\$3,442	\$226,137	\$3,766	\$233,345
Operating expenses				84,763				226,088
Interest and other income, net				1,112				9,408
Provision (benefit) for income taxes				(543 )				8,178
Consolidated net income (loss)				\$(3,392 )				\$8,487
2015								
Revenue, net	\$33,621	\$357,590	\$—	\$391,211	\$104,184	\$1,073,384	\$—	\$1,177,568
Cost of goods sold	31,989	286,771	—	318,760	95,751	860,272	—	956,023
Gross profit	\$1,632	\$70,819	\$—	\$72,451	\$8,433	\$213,112	\$—	\$221,545
Operating expenses				75,822				218,990
Interest and other income, net				739				2,576
Provision (benefit) for income taxes				(15 )				3,774
Consolidated net income (loss)				\$(2,617 )				\$1,357

The direct segment includes revenues, direct costs, and cost allocations associated with sales of inventory we own. Costs for this segment include product costs, freight, warehousing and fulfillment costs, credit card fees and customer service costs.

The partner segment includes revenues, direct costs and cost allocations associated with sales of inventory owned by our 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, 2016 and 2015, substantially all of our sales revenues were attributable to customers in the United States. At September 30, 2016 and December 31, 2015, substantially all of our fixed assets were located in the United States.

## 9. BROKER DEALERS

As part of our Medici blockchain and fintech technology initiatives, we hold a controlling interest in each of two broker dealers, SpeedRoute LLC ("SpeedRoute") and Pro Securities LLC ("Pro Securities"), which we acquired in January 2016 (see Note 3. Acquisitions).

SpeedRoute is an electronic, agency-only FINRA-registered broker dealer that provides connectivity for its customers to U.S. equity exchanges as well as off-exchange sources of liquidity such as dark pools. All of SpeedRoute's customers are registered broker dealers. SpeedRoute also does not hold, own or sell securities.

Pro Securities is a FINRA-registered broker dealer that owns and operates the Pro Securities alternative trading system ("ATS"), which is registered with the SEC. An ATS is a trading system that is not regulated as an exchange, but is a licensed venue for matching buy and sell orders. The Pro Securities ATS is a closed system available only to its broker dealer subscribers. Pro Securities does not accept orders from non-broker dealers, nor does it hold, own or sell securities.

Table of Contents

SpeedRoute and Pro Securities are subject to the SEC's Uniform Net Capital Rule (SEC Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1 and that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1. At September 30, 2016, SpeedRoute had net capital of \$1,098,634, which was \$970,503 in excess of its required net capital of \$128,131 and SpeedRoute's net capital ratio was 1.8 to 1. At September 30, 2016, Pro Securities had net capital of \$40,091, which was \$35,091 in excess of its required net capital of \$5,000 and Pro Securities net capital ratio was 0.14 to 1.

During the three months ended September 30, 2016, SpeedRoute incurred commission expense to Pro Securities in the amount of \$45,000. During the nine months ended September 30, 2016, the amount incurred was \$135,000. During the three months ended September 30, 2016, SpeedRoute paid technological related services, rent and managerial support to a related entity in the amount of \$886,500. During the nine months ended September 30, 2016, the amount paid was \$2.8 million.

SpeedRoute and Pro Securities did not have any securities owned or securities sold, not yet purchased at September 30, 2016.

Table of Contents

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

Special Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents incorporated herein by reference, as well as our other public documents and statements our officers and representatives may make from time to time, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. 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 beliefs regarding our ability to attract and retain customers in a cost-efficient manner;
- the anticipated effectiveness of our marketing;
- our future operating and financial results, including any projections of revenue, profits or losses, contribution, technology expense, general and administrative expense, cash flow, capital expenditures or other financial measures or amounts or non-GAAP financial measures or amounts or anticipated changes in any of them;
- our plans and expectations regarding our new corporate headquarters near Salt Lake City, Utah;
- our beliefs and expectations regarding the adequacy of our office and warehouse;
- our expectations regarding the benefits and risks of the credit facility we entered into for the purpose of, among other things, financing a portion of the costs of our new corporate headquarters;
- 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 or incur in the future;
- the competition we currently face and will face in our business as the ecommerce business continues to evolve and to become more competitive, and as additional competitors, including competitors based in China or elsewhere, continue to increase their efforts in our primary markets;
- the effects of government regulation;
- our plans for international markets, our expectations for our international sales efforts and the anticipated results of our international operations;
- our plans and expectations regarding Supplier Oasis and our efforts to provide multi-channel fulfillment services;
- our plans and expectations regarding our insurance product offerings and consumer finance offerings;
- our plans for further changes to our business;
- our beliefs regarding current or future litigation or regulatory actions;
- our beliefs regarding the costs and benefits of our "spend and defend" policy under which we generally refuse to settle abusive patent suits brought against us;
- our beliefs and expectations regarding existing and future tax laws and related laws and the application of those laws to our business including the assessments we have received from the Department of Revenue of the State of Washington;
- our beliefs regarding the adequacy of our insurance coverage;
- our beliefs regarding the adequacy and anticipated functionality of our infrastructure, including our backup facilities and beliefs regarding the adequacy of our disaster planning and our ability to recover from a disaster or other interruption of our ability to operate our website at its highest level of functionality;
- our beliefs regarding our cybersecurity efforts and measures and our efforts to prevent data breaches and the costs we will incur in our ongoing efforts to avoid interruptions to our product offerings and other business processes from cyber attacks and from data breaches;
-



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;

31

---

Table of Contents

- our expectations regarding the costs and benefits of our other businesses, innovations and projects including our new and used car listing service, our Worldstock Fair Trade offerings, our Main Street Revolution offerings and our ecommerce marketplace channel offerings;
- our expectations regarding the costs, benefits and risks of our efforts to develop blockchain and fintech technology and of the costs, benefits and risks of our recent acquisitions of the assets and operations of a financial technology company and two registered broker dealers affiliated with the fintech business;
- our expectations regarding the costs and benefits of various programs we offer, including Club O and programs pursuant to which we offer free or discounted participation in Club O or other programs we offer to members of the United States Armed Forces and/or to full-time, post-secondary students or others, and including our community site and our public service pet adoption program;
- our expectations regarding the costs and benefits of transitioning some of our marketing efforts from coupons to rewards for our Club O members;
- our belief that we and our 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 will 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, likely, expect, plan, seek, intend, anticipate, project, believe, estimate, predict, potential, goal, strategy, future 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;
- any downturn in the U.S. housing industry;
- 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 or via mobile apps;
- any failure to maintain our existing relationships or build new relationships with 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;
- any difficulties we may have with the quality or safety of the products we offer;
- modifications we may make to our business model from time to time, including aspects relating to our product mix and the mix of direct/partner sourcing of the products we offer;
- the mix of products purchased by our customers;
- any problems we may have with cyber security or data breaches or Internet or other infrastructure or communications impairment problems or the costs of preventing or responding to any such problems;
- any 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 or any difficulties we may have maintaining compliance with the rules of the credit card processors;
- any problems we may encounter as a result of the implementation in the U.S. of the EMV (Europay, MasterCard and Visa) standards for credit cards, which generally became effective in the U.S. in 2015, including any problems that may result from any increase in online fraud as a result of the implementation of the EMV standards;
- problems with or affecting 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 the large volume of fraudulent purchase orders we receive on a daily basis;

problems we may encounter as a result of the listing or sale of pirated, counterfeit or illegal items by third parties;  
difficulties we may have financing our operations or our expansion with either internally generated funds or external sources of financing;

32

---

Table of Contents

any environmental or other difficulties we may encounter relating to the real estate we recently purchased; any difficulties we encounter with our new corporate headquarters, our financing of a substantial portion of the costs of our new headquarters or the interest rate swaps we entered into in connection with the financing;

any difficulties we may encounter in connection with Supplier Oasis or our efforts to provide multi-channel fulfillment services, our Farmers Market offerings, our insurance product offerings, our consumer finance offerings or other businesses or product or service offerings outside of our main shopping website offerings;

any difficulties we may encounter as a result of our reliance on third parties that we do not control for the performance of critical functions material to our business;

any difficulties we may encounter in connection with the rapid shift of ecommerce and online payments to mobile and multi-channel commerce and payments;

the extent to which we owe income or sales taxes or are required to collect sales taxes or report sales or to modify our business model in order to avoid being required to collect sales taxes or report sales or avoid the application of other types of taxes;

any difficulties we may encounter as a consequence of accepting or holding bitcoin or other cryptocurrencies, whether as a result of regulatory, tax or other legal issues, technological issues, value fluctuations, lack of widespread adoption of bitcoins or other cryptocurrencies as an acceptable medium of exchange or otherwise;

increasing competition, including competition from well-established competitors including Amazon.com, competition from competitors based in China or elsewhere, competition from companies willing to incur substantial losses in order to build market share, and from others including competitors with business models that may include delivery capabilities that we may be unable to match;

difficulties with the management of our growth and any periods in which we fail to grow in accordance with our plans;

fluctuations in our operating results;

difficulties we may encounter in connection with our efforts to expand internationally;

difficulties we may encounter in connection with our efforts to offer additional types of services to our customers, including insurance products and consumer financing;

difficulties, including expense and any operational or regulatory issues we may encounter in connection with the integration or operation of the assets and operations of the financial technology company and two registered broker dealers affiliated with the fintech business that we recently acquired;

technical, operational, regulatory or other difficulties we may encounter in connection with our efforts to develop blockchain and fintech technology, or with the operation of tØ.com's system for the trading of securities;

difficulties we may encounter with our Medici blockchain and fintech technology initiatives due to lack of market acceptance or as a result of competition from any of the numerous other competitors seeking to develop competing technologies or systems or as a result of patents that may be granted to other companies or persons;

any impairment we may recognize with respect to assets or businesses that we have acquired or may acquire;

any impairment we may recognize with respect to our investments in companies that are in the startup or development stages;

any liability or expense we may incur as a result of our investments in other companies, whether as a result of regulatory issues or otherwise;

the outcomes of legal proceedings, investigations and claims, including, the outcome of the assessments we have received from the Department of Revenue of the State of Washington;

any difficulties we have optimizing our warehouse operations;

risks of inventory management and seasonality;

the cost and availability of traditional and online advertising, the rapid changes in the online advertising business and the longer-term changes in the traditional advertising business, and the results of our various brand building and marketing campaigns;

risks that the amount of deferred tax assets we consider realizable could be reduced if estimates of future taxable income during the carryforward period are reduced; and

the other risks described in this report or in our other public filings.

In evaluating all forward-looking statements, you should specifically consider the risks outlined above and in this Quarterly Report on Form 10-Q in Part II, Item 1A under the caption "Risk Factors," in Part I, Item 2 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Part II, Item 1 under the caption "Legal Proceedings," and elsewhere in this report. These factors may cause our actual results to differ materially from

## Table of Contents

those contemplated by any forward-looking statement. Although we believe that our expectations reflected in the forward-looking statements are reasonable, we cannot guarantee or offer any assurance of future results, levels of activity, performance or achievements or other future events.

Our forward-looking statements contained in this report 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 or any changes in our expectations or any change in any events, conditions or circumstances on which any of our forward-looking statements are based.

## 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 Investor Relations section of our main website [www.overstock.com](http://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 a broad range of price-competitive brand name, non-brand name and closeout products, including furniture, home decor, bedding and bath, housewares, jewelry and watches, apparel and designer accessories, health and beauty products, electronics and computers, and sporting goods, among other products. We also 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](http://www.overstock.com), [www.o.co](http://www.o.co) and [www.o.biz](http://www.o.biz) (referred to collectively as the "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 near Salt Lake City, Utah, was founded in 1997. We launched our initial website in March 1999 and were re-incorporated in Delaware in 2002. As used herein, "Overstock," "Overstock.com," "O.co," "we," "our" and similar terms include Overstock.com, Inc. and its consolidated subsidiaries, unless the context indicates otherwise.

We deal primarily in price-competitive, new, replenishable and closeout merchandise and use the Internet to aggregate both supply and demand to create an efficient marketplace for selling these products. We provide our customers an opportunity to conveniently shop for a broad range of price-competitive products. 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 provide suppliers with access to a large customer base and convenient services for order fulfillment, customer service, returns handling, and other services. The merchandise offered on our Website is from a variety of sources including well-known, brand-name manufacturers. We have organized our shopping business (sales of product offered through the Shopping Section of our Website) into two principal segments—a "direct" business and a "partner" business. Consumers and businesses are able to access and purchase our products 24 hours a day from the convenience of a computer, Internet-enabled mobile telephone or other Internet-enabled device. Our team of customer service representatives assists customers by telephone, instant online chat and e-mail. We also derive revenue from other businesses advertising products or services on our Website. Our sales are primarily to customers located in the United States.

Our direct business includes sales made to individual consumers and businesses from our owned inventory and that are fulfilled primarily from our warehouse in Salt Lake City, Utah. For our partner business, we sell merchandise from

manufacturers, distributors and other suppliers ("partners") primarily through our Website. We are considered to be the primary obligor for the majority of these sales transactions and we record revenue from the majority of these sales transactions on a gross basis. Our use of the term "partner" does not mean that we have formed any legal partnerships with any of our partners. These third party partners generally perform the same fulfillment operations as our warehouses, such as order picking and shipping; however, we handle returns and customer service related to substantially all orders placed through our Website. Revenue generated from sales on our Shopping site from both the direct and partner businesses is recorded net of returns, coupons and other discounts.

In late 2014, we began working on initiatives to develop blockchain and fintech technology which we refer to collectively as Medici and which includes our majority owned subsidiary tØ.com, Inc. (formerly Medici, Inc.). In Q1 2016, we

Table of Contents

completed the acquisition of a financial technology company and two related registered broker-dealers as part of this initiative, and we are currently working on several financial applications of blockchain technology.

35

---



## 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 “Special Cautionary Note Regarding Forward-Looking Statements.”

Revenues in Q3 2016 increased 13% compared to Q3 2015. The growth in revenue was primarily due to a 10% increase in orders, coupled with a 5% increase in average order size. These increases were partially offset by increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. Our average order size has increased in recent years due primarily to a sales mix shift into home and garden products. We are uncertain how long this trend will continue.

Gross profit in Q3 2016 increased 10% compared to Q3 2015 primarily as a result of revenue growth. Gross margin decreased to 18.1% in Q3 2016 compared to 18.5% in Q3 2015. The decrease in gross margin was primarily due to increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, partially offset by a continued shift in sales mix into higher margin home and garden products.

Sales and marketing expenses as a percentage of revenue increased from 7.7% to 7.9% during Q3 2016 as compared to the same period in 2015, primarily due to increased spending in the sponsored search marketing channels and increased staff related costs, partially offset by lower television marketing spend.

As a result of these factors, our Contribution increased 12% in Q3 2016 compared to Q3 2015 (see Non-GAAP Financial Measures below for a reconciliation of Contribution to Gross Profit). Contribution margin of 11.1% in Q3 2016 compared to 11.2% in Q3 2015.

Technology expenses in Q3 2016 increased \$1.7 million compared to Q3 2015, primarily due to an increase in depreciation and amortization of \$1.6 million.

General and administrative expenses in Q3 2016 increased \$2.6 million compared to Q3 2015, primarily due to an increase of \$3.4 million in staff related costs and \$1.1 million in bad debt expense for accounts receivable due from an international marketplace in which we also have a minority investment. These increases were partially offset by a \$2.2 million decrease in legal fees.

During Q3 2016, we recognized an impairment charge of \$2.9 million in Other income, net related to an international marketplace company in which we hold a minority investment that has historically been recorded at cost.

In Q1 2016, we entered into a settlement agreement in our prime broker litigation which concluded the litigation in its entirety and we recognized settlement proceeds of \$19.5 million. Related costs associated with the litigation and settlement of approximately \$1.0 million were included in G&A expenses during Q1 2016.

As part of our Medici initiatives to develop blockchain and fintech technology, in Q1 2016, we completed the acquisition of two registered broker-dealers. In 2015 we acquired a related financial technology company.

We continue to seek opportunities for growth, through our Medici blockchain and fintech technology initiatives and other means. As a result of these initiatives, we may continue to incur additional expenses. We may also make investments in, or acquisitions of other technologies and businesses. These expenses, acquisitions or investments may be material, and, coupled with the seasonality of our business, may lead to reduced income or to losses in some periods, and to reduced liquidity.

During Q3 2016, we substantially completed the construction of our new corporate headquarters near Salt Lake City, Utah. We estimate that the total project will cost approximately \$99.2 million and as of September 30, 2016 we have incurred approximately \$95.1 million in costs toward the project. We began to occupy the building in August 2016. The construction project and related financing is discussed in further detail in the Liquidity and Capital Resources, Borrowings section below.

Table of Contents

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.

37

---

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, 2016		2015		Nine months ended September 30, 2016		2015	
	(as a percentage of total net revenue)				(as a percentage of total net revenue)			
Revenue, net								
Direct	5.6	%	8.6	%	6.0	%	8.8	%
Partner and other	94.4		91.4		94.0		91.2	
Total net revenue	100.0		100.0		100.0		100.0	
Cost of goods sold								
Direct	5.4		8.2		5.7		8.1	
Partner and other	76.5		73.3		76.0		73.1	
Total cost of goods sold	81.9		81.5		81.7		81.2	
Gross profit	18.1		18.5		18.3		18.8	
Operating expenses:								
Sales and marketing	7.9		7.7		7.8		7.3	
Technology	6.1		6.4		6.1		6.1	
General and administrative	5.3		5.3		5.3		5.1	
Litigation settlement	—		—		(1.5	)	—	
Total operating expenses	19.2		19.4		17.7		18.6	
Operating income (loss)	(1.1	)	(0.9	)	0.6		0.2	
Other income, net	0.3		0.2		0.7		0.2	
Income (loss) before income taxes	(0.9	)	(0.7	)	1.3		0.4	
Provision (benefit) for income taxes	(0.1	)	—		0.6		0.3	
Consolidated net income (loss)	(0.8	)%	(0.7	)%	0.7	%	0.1	%

Comparisons of Three Months Ended September 30, 2016 to Three Months Ended September 30, 2015, and Nine Months Ended September 30, 2016 to Nine Months Ended September 30, 2015

## Revenue

The following table reflects our net revenues for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
Revenue, net								
Direct	\$24,620	\$33,621	\$(9,001)	(26.8)%	\$75,901	\$104,184	\$(28,283)	(27.1)%
Partner and other	416,944	357,590	59,354	16.6	1,197,880	1,073,384	124,496	11.6
Total revenue, net	\$441,564	\$391,211	\$50,353	12.9%	\$1,273,781	\$1,177,568	\$96,213	8.2%

The primary reason for increased total net revenue for the three months ended September 30, 2016, as compared to the same period in 2015, was a 10% increase in orders, coupled with a 5% increase in average order size. The primary reason for increased total net revenue for the nine months ended September 30, 2016, as compared to the same period in 2015, was a 6% increase in orders, coupled with a 3% increase in average order size. These increases were partially

offset by increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions. Our average order size has increased in recent years due primarily to a sales mix shift into home and garden products. We are uncertain how long this trend will continue.

## Table of Contents

The primary reason for decreased direct revenue for the three and nine months ended September 30, 2016, as compared to the same periods in 2015, was a decrease in sales of home and garden products (primarily due to a shift from our direct segment to our partner segment) and increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions.

The increase in partner revenue for the three and nine months ended September 30, 2016, as compared to the same periods in 2015, was primarily due to an increase in sales of home and garden products. This increase was partially offset by increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions.

Since mid-2015 through the first half of 2016, we experienced some slowing of our overall revenue growth, which we believe was due in part to changes that Google made in its natural search engine algorithms. While we worked to adapt to Google's changes, we increased our emphasis on other marketing channels, such as sponsored search, which generated revenue growth but with higher associated marketing expenses than natural search.

We continue to seek increased participation in our Club O loyalty program, including, in certain instances, by increasing Club O Rewards to our Club O members in lieu of coupons we offer to all customers. For additional information regarding our Club O loyalty program see Item 1 of Part I, "Financial Statements (Unaudited)"—Note 2. Accounting Policies, Club O loyalty program.

The shift of business from direct to partner (or vice versa) is primarily a result of the economics of each particular product offering at the time of sale and we generally do not have particular goals for an "appropriate" mix or percentage for the size of either. Although we have experienced a trend from direct revenue to partner revenue in recent years, we believe that the mix of the business between direct and partner is consistent with our strategic objectives.

The product lines we offer, and their respective percentages of our revenue, are based on many factors including customer demand, our marketing efforts, promotional pricing and joint-marketing offered by our suppliers, and the types of liquidation inventory we are able to obtain. These factors change frequently and affect the mix of the product lines we sell. While we have experienced a trend toward our home and garden category in recent years, our business model is to deal primarily in price-competitive replenishable and closeout merchandise, which includes a wide variety of product offerings. While we do not currently expect any material shifts in our product line mix, the amount of the product lines we sell is an economic result of the factors described above, which may change from time to time.

International sales were less than 2% of total net revenues for the three and nine months ended September 30, 2016 and 2015.

### 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 pre-tax income for the three months ended September 30, 2016 (in thousands):

Change in the Estimate of Average Transit Times (Days)	Three Months Ended September 30, 2016		Pre-Tax
	Increase (Decrease) Revenue	Increase (Decrease) Income	
2	\$(16,050)	\$ (2,071	)
1	\$(6,771 )	\$ (876	)
As reported	As reported	As reported	
-1	\$4,930	\$ 636	
-2	\$9,344	\$ 1,205	

39

---

Table of Contents

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 partner business; changes in supplier cost and / or sales price; competitive pricing; inventory management decisions within the direct business; sales coupons and promotions; product mix of sales; and operational and fulfillment costs.

The following table reflects our net revenues, cost of goods sold and gross profit for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
Revenue, net								
Direct	\$24,620	\$33,621	\$(9,001)	(26.8)%	\$75,901	\$104,184	\$(28,283)	(27.1)%
Partner and other	416,944	357,590	59,354	16.6	1,197,880	1,073,384	124,496	11.6
Total net revenue	\$441,564	\$391,211	\$50,353	12.9%	\$1,273,781	\$1,177,568	\$96,213	8.2%
Cost of goods sold								
Direct	\$23,955	\$31,989	\$(8,034)	(25.1)%	\$72,459	\$95,751	\$(23,292)	(24.3)%
Partner and other	337,893	286,771	51,122	17.8	967,977	860,272	107,705	12.5
Total cost of goods sold	\$361,848	\$318,760	\$43,088	13.5%	\$1,040,436	\$956,023	\$84,413	8.8%
Gross Profit								
Direct	\$665	\$1,632	\$(967)	(59.3)%	\$3,442	\$8,433	\$(4,991)	(59.2)%
Partner and other	79,051	70,819	8,232	11.6	229,903	213,112	16,791	7.9
Total gross profit	\$79,716	\$72,451	\$7,265	10.0%	\$233,345	\$221,545	\$11,800	5.3%

Gross margins for the past seven quarterly periods and fiscal year ending 2015 were:

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	FY 2015	Q1 2016	Q2 2016	Q3 2016
Direct	10.0%	9.3%	4.9%	3.8%	7.0%	4.7%	6.2%	2.8%
Partner and other	19.8%	19.9%	19.8%	18.3%	19.4%	19.7%	19.0%	19.1%
Combined	18.9%	19.0%	18.5%	17.3%	18.4%	18.7%	18.2%	18.2%

Gross profit for the three months ended September 30, 2016 increased 10% as compared to the same period in 2015, primarily as a result of revenue growth. Gross margin decreased to 18.1% as compared to 18.5% during the same periods. Gross profit for the nine months ended September 30, 2016 increased 5% as compared to the same period in 2015, primarily as a result of revenue growth. Gross margin decreased to 18.3% as compared to 18.8% during the same periods. These decreases in gross margin were primarily due to increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, partially offset by a continued shift in sales mix into higher margin home and garden products.

The 215 and 356 basis point decreases in direct gross margin for the three and nine months ended September 30, 2016, respectively, as compared to the same periods in 2015, were primarily due to increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, and increased warehousing costs due to additional warehouse space, partially offset by a shift in sales mix into higher margin products.



The 85 and 66 basis point decreases in partner gross margin for the three and nine months ended September 30, 2016, respectively, as compared to the same periods in 2015, were primarily due to increased promotional activities, including coupons, site sales, and Club O Rewards (which we recognize as a reduction of revenue) due to our driving a higher proportion of our sales using such promotions, partially offset by a continued shift in sales mix into higher margin home and garden products.

40

---

Table of Contents

Cost of goods sold includes stock-based compensation expense of \$69,000 and \$52,000 for the three months ended September 30, 2016 and 2015, respectively, and \$200,000 and \$129,000 for the nine months ended September 30, 2016 and 2015, respectively.

See “Executive Commentary” above for additional discussion.

## Fulfillment costs

Fulfillment costs include all warehousing costs, including fixed overhead and variable handling costs (excluding packaging costs), as well as credit card fees and customer service costs, all of which we include as costs in calculating gross margin. We believe that some companies in our industry, including some of our competitors, account for fulfillment costs within operating expenses, and therefore exclude fulfillment costs from gross margin. As a result, our gross margin may not be directly comparable to others in our industry.

The following table has been included to provide investors additional information regarding our classification of fulfillment costs, gross profit and margin, thus enabling investors to better compare our gross margin with others in our industry (in thousands):

	Three months ended				Nine months ended			
	September 30,		September 30,		September 30,		September 30,	
	2016	2015	2016	2015	2016	2015	2016	2015
Total revenue, net	\$441,564	100%	\$391,211	100%	\$1,273,781	100%	\$1,177,568	100%
Cost of goods sold								
Product costs and other cost of goods sold	343,401	78%	301,164	77%	985,603	77%	903,720	77%
Fulfillment and related costs	18,447	4%	17,596	4%	54,833	4%	52,303	4%
Total cost of goods sold	361,848	82%	318,760	81%	1,040,436	82%	956,023	81%
Gross profit	\$79,716	18%	\$72,451	19%	\$233,345	18%	\$221,545	19%

Fulfillment costs as a percentage of sales may vary due to several factors, such as our ability to manage costs at our warehouses, significant changes in the number of units received and fulfilled, the extent to which we use third party fulfillment services and warehouses, and our ability to effectively manage customer service costs and credit card fees. Fulfillment and related costs increased slightly during the three and nine months ended September 30, 2016 as compared to the same periods in 2015.

See “Gross profit” above for additional discussion.

## Operating expenses

## Sales and marketing expenses

We use a variety of methods to target our consumer audience, including online campaigns, such as advertising through keywords, product listing ads, display ads, search engines, affiliate marketing programs, social coupon websites, portals, banners, e-mail, direct mail and viral and social media campaigns. We also do brand advertising through television, radio, print ads, and event sponsorships.

The following table reflects our sales and marketing expenses for the three and nine months ended September 30, 2016 and 2015 (in thousands):



Table of Contents

	Three months ended				Nine months ended			
	September 30,		\$ Change	% Change	September 30,		\$ Change	% Change
	2016	2015			2016	2015		
Sales and marketing expenses	\$34,707	\$30,062	\$ 4,645	15.5 %	\$99,516	\$86,121	\$ 13,395	15.6 %
Sales and marketing expenses as a percent of net revenues	7.9	% 7.7	%		7.8	% 7.3	%	

The 18 basis point increase in sales and marketing expenses as a percentage of revenue for the three months ended September 30, 2016, as compared to the same period in 2015, was primarily due to increased spending in the sponsored search marketing channel and increased staff related costs, partially offset by lower television marketing spend.

The 50 basis point increase in sales and marketing expenses as a percentage of revenue for the nine months ended September 30, 2016, as compared to the same period in 2015, was primarily due to increased spending in the sponsored search marketing channels, in part in response to changes we believe Google made in its natural search engine algorithms, and increased staff related costs, partially offset by decreased spend on display ad marketing.

Sales and marketing expenses include stock-based compensation expense of \$102,000 and \$50,000 for the three months ended September 30, 2016 and 2015, respectively, and \$234,000 and \$140,000 for the nine months ended September 30, 2016 and 2015, respectively.

Costs associated with our discounted shipping and other promotions, such as coupons, are not included in marketing expense. Rather, they are accounted for as a reduction of revenue and therefore affect sales and gross margin. We consider discounted shipping and other promotions, such as our policy of free shipping on orders over \$45, as an effective marketing tool, and intend to continue to offer them as we deem appropriate as part of our overall marketing plan.

We constantly evaluate where we spend our sales and marketing dollars. From time to time, certain competitors may bid up the cost of certain marketing channels, such as paid keywords. At such times, we may reduce the amounts we spend in those marketing channels, which may lead to decreased visitors to our site for a time.

## Technology expenses

We seek to invest efficiently in technology, including web services, customer support solutions, website search, expansion of new and existing product categories, and in investments in technology to enhance the customer experience, improve our process efficiency and support and expand our logistics infrastructure. We expect to continue to increase our technology expenses to support these initiatives and these increases may be material.

The frequency and variety of cyber attacks on our Website, our corporate systems, and on third parties that we use to support our technology continue to increase, including an attack that took place in October 2016 which interrupted traffic for several major websites in the United States. The impact of these attacks, their costs, and the costs we incur to protect ourselves against future attacks have not been material. However, we consider the threat from cyber attacks to be serious and will continue to incur costs related to protecting ourselves against them.

The following table reflects our technology expenses for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three months ended				Nine months ended			
	September 30,		\$ Change	% Change	September 30,		\$ Change	% Change
	2016	2015			2016	2015		

Edgar Filing: OVERSTOCK.COM, INC - Form 10-Q

Technology expenses	\$26,739	\$25,084	\$ 1,655	6.6	%	\$78,249	\$72,230	\$ 6,019	8.3	%
Technology expenses as a percent of net revenues	6.1	%	6.4	%		6.1	%	6.1	%	

The \$1.7 million increase in technology costs for the three months ended September 30, 2016, as compared to the same period in 2015, was primarily due to an increase in depreciation and amortization expense of \$1.6 million.

Table of Contents

The \$6.0 million increase in technology costs for the nine months ended September 30, 2016, as compared to the same period in 2015, was primarily due to an increase in depreciation and amortization of \$4.5 million and an increase in staff-related costs of \$2.0 million.

We continue to seek opportunities for growth by expanding our sales and distribution footprint, through our Medici initiatives and other means. As a result of these initiatives, we may continue to incur additional expenses. We may also make investments in, or acquisitions of, other technologies and businesses. These expenses, acquisitions or investments may be material, and, coupled with the seasonality of our business, may lead to reduced income or to losses in some periods, and to reduced liquidity. During the three months ended September 30, 2016, our Medici-related subsidiaries incurred a pre-tax loss of approximately \$3.0 million, which includes \$1.2 million of amortization and depreciation expense. During the nine months ended September 30, 2016, our Medici-related subsidiaries incurred a pre-tax loss of approximately \$9.2 million, which includes \$3.5 million of amortization and depreciation expense.

Technology expenses include stock-based compensation expense of \$210,000 and \$165,000 for the three months ended September 30, 2016 and 2015, respectively, and \$615,000 and \$491,000 for the nine months ended September 30, 2016 and 2015, respectively.

#### General and administrative expenses

The following table reflects our general and administrative expenses ("G&A") for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
General and administrative expenses	\$23,317	\$20,676	\$ 2,641	12.8 %	\$67,843	\$60,639	\$ 7,204	11.9 %
General and administrative expenses as a percent of net revenues	5.3	% 5.3	%		5.3	% 5.1	%	

The \$2.6 million increase in general and administrative expenses ("G&A") for the three months ended September 30, 2016, as compared to the same period in 2015, was primarily due to an increase of \$3.4 million in staff related costs, and \$1.1 million in bad debt expense for accounts receivable due from an international marketplace in which we also have a minority investment (and for which we recognized an impairment charge during the quarter in other income, net). These increases were partially offset by a \$2.2 million decrease in legal fees.

The \$7.2 million increase in general and administrative expenses ("G&A") for the nine months ended September 30, 2016, as compared to the same period in 2015, was primarily due to an increase of \$6.7 million in staff related costs, \$1.1 million in bad debt expense for accounts receivable due from an international marketplace in which we also have a minority investment (and for which we recognized an impairment charge during the quarter in other income, net), a \$1.0 million increase in office and facilities costs, and a \$547,000 contract termination fee, partially offset by a \$2.2 million decrease in legal fees.

G&A expenses include stock-based compensation expense of approximately \$1.0 million and \$572,000 for the three months ended September 30, 2016 and 2015, respectively, and \$3.1 million and \$1.8 million for the nine months ended September 30, 2016 and 2015, respectively.

Litigation settlement

In Q1 2016, we entered into a settlement agreement in our prime broker litigation which concluded the litigation in its entirety and we recognized settlement proceeds of \$19.5 million. Related costs associated with the litigation and settlement of approximately \$1.0 million were included in G&A expenses during Q1 2016.

Depreciation and amortization expense

43

---

Table of Contents

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Cost of goods sold - direct	\$77	\$73	\$235	\$206
Technology	6,952	5,875	18,755	16,331
Marketing	29	—	29	—
General and administrative	357	284	691	847
Total depreciation, including internal-use software and website development	\$7,415	\$6,232	\$19,710	\$17,384

Amortization of intangible assets other than goodwill is classified within the corresponding operating expense categories on the consolidated statements of operations as follows (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Technology	699	189	2,151	189
General and administrative	273	192	1,042	254
Total amortization of intangible assets other than goodwill	\$972	\$381	\$3,193	\$443

## Interest expense

The \$150,000 and \$145,000 increases in interest expense for the three and nine months ended September 30, 2016, respectively, as compared to the same periods in 2015, were primarily due to changes in the expense recognition of our interest rate swap and the interest from our loan and financing agreements related to the construction of our new corporate headquarters. As a result of the substantial completion of the headquarters during Q3 2016, we no longer recognize interest rate swap payments in accumulated other comprehensive income and we no longer capitalize the interest of the related loan and financing agreements. To the extent that our interest rate swap is effective, future changes in its fair value will be recognized in Accumulated other comprehensive income (loss). Any ineffective portion will be immediately recognized in Other income, net. For additional information see Item 1 of Part I, "Financial Statements (Unaudited)"—Note 2. Accounting Policies, Derivative financial instruments.

## Other income, net

The \$487,000 increase in other income, net for the three months ended September 30, 2016, as compared to the same period in 2015, is primarily due to an increase in Club O Rewards breakage of \$2.6 million due to growth in the Club O Rewards program, including our Club O Silver program, and a decrease in unrealized losses on our precious metals of \$610,000. These increases were partially offset by an impairment charge of \$2.9 million related to an international marketplace company in which we hold a minority investment that has historically been recorded at cost.

The \$6.9 million increase in other income, net for the nine months ended September 30, 2016, as compared to the same period in 2015, is primarily due to an increase in Club O Rewards breakage of \$8.8 million due to growth in the Club O Rewards program, including our Club O Silver program. These increases were partially offset by an impairment charge of \$2.9 million related to an international marketplace company in which we hold a minority



investment that has historically been recorded at cost.

Beginning in 2015, we enrolled a significant number of members in Club O Silver, a newly introduced Club O membership tier for customers who agree to receive promotional emails. Club O Silver members earned Club O Rewards on qualifying purchases that expire after 90 days from a qualifying purchase. We discontinued Club O Silver in October 2016. Since the program's introduction, the growth in Club O Silver caused increases in reward dollars and resulting breakage. The increases in reward breakage attributable to Club O Silver may continue as compared to prior periods for several months until all remaining Club O Silver rewards have expired.

44

---

## Table of Contents

### Income taxes

Our provision (benefit) for income taxes for the three months ended September 30, 2016 and 2015 was \$(543,000) and \$(15,000), respectively. The increase in the benefit was primarily due to an increase in our pre-tax loss during the three months ended September 30, 2016 as compared to the same period in 2015.

Our provision for income taxes for the nine months ended September 30, 2016 and 2015 was \$8.2 million and \$3.8 million, respectively. The increase in the provision was primarily due to an increase in pre-tax income during the nine months ended September 30, 2016 as compared to the same period in 2015.

The effective tax rate for the nine months ended September 30, 2016 and 2015 was 49.1% and 73.5%, respectively. The decrease in the effective tax rate is primarily attributable to our increased ownership of our majority-owned subsidiary tØ.com, Inc. (formerly Medici, Inc.). Prior to Q3 2015, we owned 75.1% of tØ.com. Tax losses incurred while holding less than 80% of the business cannot offset our consolidated taxable income and are fully valued. The operating losses that tØ.com incurred after we increased our ownership during Q3 2015 do not require a valuation allowance since the subsidiary now qualifies for tax consolidation. The decrease in the effective tax rate was partially offset by an increase to the effective tax rate related to an impairment loss on a minority investment in an international marketplace that we recognized during the three and nine months ended September 30, 2016, for which no tax benefit can be recorded.

We have indefinitely reinvested foreign earnings of \$457,000 at September 30, 2016. We would need to accrue and pay U.S. income tax on this amount if repatriated. We do not intend to repatriate these earnings.

Our quarterly tax provision and our quarterly estimate of our annual effective tax rate are subject to significant variations due to several factors including variability in predicting our pre-tax and taxable income and the mix of jurisdictions to which those items relate, relative changes of expenses or losses for which tax benefits are not recognized, how we do business, and changes in law, regulations, and administrative practices. Our effective tax rate can be volatile based on the amount of pre-tax income. For example, the impact of discrete items on our effective tax rate is greater when pre-tax income is lower.

We assess the available positive and negative evidence to estimate whether we will generate sufficient future taxable income to use the existing deferred tax assets. We consider, among other things, our recent historical financial and operating results (three years of cumulative income and revenue growth during those periods), along with our forecasted growth rates, projected future taxable income, including the impact of any costs associated with our recent acquisition, and tax planning strategies. We perform multiple sensitivity analyses to address how potential changes in significant assumptions would impact our ability to generate the minimum amount of taxable income required. We give the most weight to objective evidence related to our more recent financial results. Based upon the level of historical taxable income and projections for future taxable income, including the impact of any acquisition costs, and planned tax strategies over the periods in which the deferred tax assets are deductible, we believe it is more likely than not that we will realize the benefits of these deduction differences, net of existing valuation allowances. However, it is possible that certain state tax credits could ultimately expire unused if estimates of future apportioned taxable income during the carryforward period are reduced.

### Seasonality

Based upon our historical experience, revenue typically increases during the fourth quarter because of the holiday retail season and gross margin decreases due to increased sales of certain lower margin products, such as electronics. The actual quarterly results for each quarter could differ materially depending upon consumer preferences, availability

of product and competition, among other risks and uncertainties. Accordingly, there can be no assurances that seasonal variations will not materially affect our results of operations in the future.

Table of Contents

The following table reflects our total net revenues for each of the quarters in 2016, 2015 and 2014 (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2016	\$413,677	\$418,540	\$441,564	\$N/A
2015	398,344	388,013	391,211	480,270
2014	341,207	332,545	352,991	470,360

## Liquidity and Capital Resources

## Current sources of liquidity

We believe that the cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months. Our failure to generate sufficient revenues or profits or to obtain additional financing or raise additional capital could have a material adverse effect on our operations and on our ability to achieve our intended business objectives. Any projections of future cash needs and cash flows are subject to substantial uncertainty.

During Q3 2016, we substantially completed the construction of our new corporate headquarters near Salt Lake City, Utah and we began to occupy the building. We have incurred total project costs, including the cost of the land and related equipment and furniture, of approximately \$95.1 million. We estimate that the total project will cost approximately \$99.2 million. In 2014, we entered into a credit facility which provides for an approximately 27-month construction loan of \$45.8 million (which is designed to subsequently convert into an approximately 6.75-year term loan following completion of the construction of the headquarters), and a three-year \$10 million revolving loan. At September 30, 2016 our outstanding liability on the construction loan was approximately \$40.9 million. For additional information, see Borrowings - U.S. Bank term loan and revolving loan agreement below.

In November 2015, we entered into a Master Lease Agreement ("MLA") with U.S. Bank pursuant to which we may finance certain assets or sell certain assets to U.S. Bank and simultaneously lease them back. The agreement also allows us to finance software licenses (inclusive of the assets, referred to collectively as the "Leased Assets"). The MLA allows for leases and financing of up to \$20 million. At September 30, 2016, our outstanding liability under the MLA was approximately \$10.3 million. For additional information, see Borrowings - U.S. Bank master lease agreement below.

Our principal sources of liquidity are cash flows generated from operations, and our existing cash and cash equivalents. At September 30, 2016, we had cash and cash equivalents of \$124.5 million.

Cash flow information is as follows (in thousands):

	Nine months ended September 30,		Twelve months ended September 30,	
	2016	2015	2016	2015
Cash provided by (used in):				
Operating activities	\$(15,439)	\$(36,400)	\$75,477	\$44,930
Investing activities	(65,166 )	(66,239 )	(81,358 )	(77,733 )
Financing activities	34,814	2,266	49,084	1,331

Free cash flow

“Free Cash Flow” (a non-GAAP measure) for the nine months ended September 30, 2016 and 2015, was \$(74.8) million and \$(79.8) million, respectively, and \$(37,000) and \$(7.3) million for the twelve months ended September 30, 2016 and 2015, respectively. See Non-GAAP Financial Measures below for a reconciliation of Free Cash Flow to net cash provided by (used in) operating activities.

Cash flows from operating activities

46

---

## Table of Contents

For the nine months ended September 30, 2016 and 2015, our operating activities resulted in net cash outflows of \$15.4 million and \$36.4 million, respectively.

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

The \$15.4 million of net cash used in operating activities during the nine months ended September 30, 2016 was primarily due to decreases in accounts payable of \$40.2 million, accrued liabilities of \$8.7 million and deferred revenue of \$9.7 million. Accounts payable, accrued liabilities and deferred revenue decreased due to seasonality which caused high balances at year-end 2015 and a significant decline during 2016. The net cash used by operating activities during the nine months ended September 30, 2016 was partially offset by non-cash depreciation expense of \$19.7 million, consolidated net income of \$8.5 million and deferred income taxes of \$6.7 million.

The \$36.4 million of net cash used in operating activities during the nine months ended September 30, 2015 was primarily due to decreases in accounts payable of \$47.3 million, accrued liabilities of \$17.8 million, prepaids and other assets of \$3.8 million and deferred revenue of \$3.3 million. Accounts payable, accrued liabilities and deferred revenue decreased due to seasonality which caused high balances at year-end 2014 and a significant decline during 2015. The net cash used by operating activities during the nine months ended September 30, 2015 was partially offset by non-cash depreciation and amortization expense of \$17.8 million, deferred income taxes of \$3.5 million, and a decrease in inventories of \$3.0 million.

### Cash flows from investing activities

For the nine months ended September 30, 2016, investing activities resulted in net cash outflows of \$65.2 million primarily due to \$59.4 million of expenditures for fixed assets, \$4.0 million in cost method investments and a \$3.1 million disbursement for loans made.

For the nine months ended September 30, 2015, investing activities resulted in net cash outflows of \$66.2 million primarily due to \$43.4 million of expenditures for fixed assets, \$10.6 million of acquisitions of businesses, and \$7.0 million in cost method investments and \$5.0 million of disbursements for loans made.

### Cash flows from financing activities

For the nine months ended September 30, 2016, financing activities resulted in net cash inflows of \$34.8 million primarily due to \$31.4 million of proceeds from our U.S. Bank term loan and \$6.1 million of proceeds from lease finance obligations with U.S. Bank.

For the nine months ended September 30, 2015, financing activities resulted in net cash inflows of \$2.3 million primarily due to \$5.5 million of proceeds from the issuances of privately-placed digital cryptobonds, offset by \$2.4 million of purchase of shares of our common stock withheld for minimum tax withholdings upon the vesting of a portion of certain restricted stock award grants.



Table of Contents

## Contractual Obligations and Commitments

The following table summarizes our contractual obligations as of September 30, 2016 and the effect such obligations and commitments are expected to have on our liquidity and cash flow in future periods (in thousands):

Contractual Obligations	Payments Due by Period						Total
	Remainder of 2016	2017	2018	2019	2020	Thereafter	
Operating leases	\$2,479	\$8,592	\$6,359	\$5,822	\$4,038	\$24,513	\$51,803
Purchase obligations	7,411	—	—	—	—	—	7,411
Headquarters construction costs	8,098	—	—	—	—	—	8,098
U.S. Bank term loan payments	287	2,302	2,272	2,243	2,217	43,965	53,286
U.S. Bank master lease agreement	787	4,329	4,329	4,329	4,225	1,972	19,971
Total contractual cash obligations (1)	\$19,062	\$15,223	\$12,960	\$12,394	\$10,480	\$70,450	\$140,569

(1) As described below under "U.S. Bank Term Loan Payments," \$8.1 million of the payments shown here is duplicative. See U.S. Bank term loan payments below.

Other Commercial Commitments	Amounts of Commitment Expiration Per Period						Total
	2016	2017	2018	2019	2020	Thereafter	
Letters of credit	\$430	\$—	\$—	\$—	\$—	\$—	—\$430

## Operating leases

From time to time we enter into operating leases for facilities and equipment for use in our operations.

## Purchase obligations

The amount of purchase obligations shown above is based on assumptions regarding the legal enforceability against us of inventory purchase orders we had outstanding at September 30, 2016. Under different assumptions regarding our rights to cancel our purchase orders or different assumptions regarding the enforceability of the purchase orders under applicable law, the amount of purchase obligations shown in the table above would be less.

## Technology, marketing and other services

From time to time we enter into long-term contractual agreements for technology, marketing or other services.

## Headquarters construction costs

We have entered into various agreements under which we have incurred obligations relating to the construction of our new corporate headquarters, together with related facilities and improvements (collectively, the "Project"). We expect the total Project costs to be approximately \$99.2 million. At September 30, 2016, we had paid approximately \$91.1 million in cash toward the Project, including approximately \$11.0 million to purchase the land. Our remaining anticipated cash obligations include payments under the Construction Agreement described below, other agreements related to the Project, and remaining anticipated expenditures for fixed assets and other obligations related to the Project.

## U.S. Bank term loan payments



We have entered into a financing agreement related to the Project (see Borrowings below). The amounts presented reflect our estimated payments of principal and interest based on our remaining anticipated draws on the loan. Approximately \$8.1 million of the amounts shown in the row titled "U.S. Bank term loan payments" reflect the scheduled repayment of headquarters construction costs and is therefore duplicative.

## Table of Contents

### U.S. Bank master lease agreement

We have entered into an agreement to finance or sell and lease back certain assets (see Borrowings below). The amounts presented reflect our payments and estimated payments of principal and interest based on our current and anticipated borrowings under the agreement as of September 30, 2016.

### Construction agreement

Our wholly owned subsidiary O.com Land is party to a construction agreement (the "Construction Agreement") with Okland Construction Company Inc. ("Okland") regarding preconstruction and construction services provided by Okland in connection with the construction of the Project. In accordance with the Project Milestones as described in the Construction Agreement, Okland is required to Substantially Complete the Work (as such term is defined in the Construction Agreement) within 100 weeks following the commencement of the Construction Phase (as defined in the Construction Agreement) subject to modification under certain circumstances. Pursuant to the Construction Agreement, O.Com Land agreed to make progress payments to Okland for construction services as set forth in the Construction Agreement, and subject to a 5% retention on progress payments for the Work.

### Other obligations

In April 2016, we made a \$4.0 million investment in a financial technology company. We also agreed to make a subsequent \$3.0 million investment, and a \$3.0 million loan, that are contingent on the investee reaching certain milestones. We do not know when, or if, the investee will reach such milestones. The loan, if made, is to be repaid over three years in equal monthly installments.

### Tax contingencies

We are involved in various tax matters, the outcomes of which are uncertain. As of September 30, 2016 and December 31, 2015, tax contingencies were \$1.3 million and \$821,000, respectively. We expect the total amount of tax contingencies to increase in the future. In addition, changes in state, federal, and foreign tax laws may increase our tax contingencies. The timing of the resolution of income tax contingencies is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ from the amounts accrued. While it is reasonably possible that within the next 12 months we will receive additional assessments by various tax authorities or reach resolution of income tax contingencies in one or more jurisdictions, we do not anticipate that we will make any payments to such authorities during that period. These assessments or settlements may or may not result in changes to our contingencies related to positions on prior years' tax filings.

### Borrowings

#### U.S. Bank term loan and revolving loan agreement

In October 2014, we entered into a syndicated senior secured credit facility (the "Facility") with U.S. Bank National Association ("U.S. Bank" or the "Administrative Bank") and certain other banks in connection with the construction of our new corporate headquarters (the "Project"). The Facility is governed by a Loan Agreement dated as of October 24, 2014 which provides for an aggregate credit amount of \$55.8 million, consisting of (i) a senior secured real estate loan of \$45.8 million (the "Real Estate Loan") to be used to finance a portion of the Project and (ii) a three-year \$10.0 million senior secured revolving credit facility (the "Revolving Loan") for working capital and capital expenditures, but not for the Project. The Real Estate Loan and the Revolving Loan are both secured by the Project, our inventory and accounts receivable, substantially all of our deposit accounts and related assets. We began borrowing under the facility in October 2015.

On or about January 1, 2017 (but no later than 90 days thereafter), the Real Estate Loan is designed to convert into an approximately 6.75-year term loan due October 1, 2023 (the “Term Loan”). The conditions to conversion of the Real Estate Loan to the Term Loan include, among others, requirements that the Project must have been completed in accordance with the applicable plans, paid for in full, and generally free of liens; completion must have been certified by the project architect and the inspecting architect; certificates of occupancy must have been issued; we must have paid all amounts then due to the lending banks and must be in compliance with the covenants under the Loan Agreement; the Real Estate Loan must be brought “in balance” as defined in the Loan Agreement, which may require us to contribute additional cash to the Project; we must have paid the final amount of our cash contribution as required by the Loan Agreement; and if required by the Administrative Bank,

Table of Contents

an updated appraisal must show that the Project is in compliance with an 80% loan to value ratio requirement. If the conditions to conversion are not satisfied, all amounts outstanding under the Facility will become immediately due and payable. In August 2016, the Project was substantially completed, we obtained a temporary certificate of occupancy and we began to occupy the building. We anticipate the Real Estate Loan to convert to the Term Loan on or about January 1, 2017 (but no later than 90 days thereafter).

Amounts outstanding under the Real Estate Loan and the Term Loan carry an interest rate based on one-month LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%. However, we have entered into interest rate swap agreements designed to fix our interest rate on the Real Estate Loan and the Term Loan at approximately 4.6% annually (see Derivative financial instruments in Note 2. Accounting Policies). Monthly payments of interest only will be due and payable on the Real Estate Loan prior to conversion. Following conversion, we are required to make monthly payments of principal estimated to be \$1.1 million annually plus interest, with a balloon payment of all unpaid principal (estimated to be \$38.0 million) and interest on October 1, 2023. Amounts outstanding under the Revolving Loan will carry an interest rate based on LIBOR plus 2.00% or an Alternate Base Rate plus 1.00%.

We are required to maintain compliance as of the end of each calendar quarter with the following financial covenants:

- a fixed charge coverage ratio on a trailing 12-month basis of no less than 1.15 to 1.00;
- a cash flow leverage ratio on a trailing 12-month basis not greater than 3.00 to 1.00 during the Construction Phase (as defined in the Loan Agreement);
- a cash flow leverage ratio not greater than 2.50 to 1.00 following the Construction Phase; and
- minimum liquidity of at least \$50.0 million.

At September 30, 2016, we were in compliance with the financial covenants. In addition to the financial covenants described above, we are required to comply with a number of covenants relating to the Project and our business, including covenants limiting certain indebtedness. Notwithstanding, the Loan Agreement permits us to incur up to \$20 million of additional senior-secured indebtedness for equipment financing (as described under U.S. Bank master lease agreement below), and other senior-secured indebtedness provided that the aggregate principal amount of such other senior-secured indebtedness does not exceed ten percent of our consolidated assets. The Loan Agreement includes customary events of default in addition to events of default relating specifically to the Project. The Real Estate Loan and the Revolving Loan are cross-defaulted and cross-collateralized. In the event of a default, the default rate of interest would be 2.00% above the otherwise applicable rate. Unless it terminates earlier or is extended with the consent of the Administrative Bank and all of the Banks, the Revolving Loan facility will terminate on October 24, 2017.

As of September 30, 2016, we had borrowed \$40.9 million under the Real Estate Loan. We have not borrowed any amounts under the Revolving Loan. Our liability under the Real Estate Loan approximates fair value.

U.S. Bank master lease agreement

In November 2015, we entered into a Master Lease Agreement and a Financial Covenants Rider (collectively, the "Master Lease Agreement") with U.S. Bank Equipment Finance, a division of U.S. Bank National Association ("Lessor"). Under the Master Lease Agreement we are able to sell certain assets (the "Leased Assets") to the Lessor and simultaneously lease them back for a period of 60 months. We are also able to finance certain software licenses (inclusive in the "Leased Assets") for a period of 60 months. We have the right to repurchase the Leased Assets and terminate the Master Lease Agreement twelve months following the initial term. We also have the right to repurchase the Leased Assets at the end of the term for \$1.00. Payments on the Master Lease Agreement are due monthly. During the nine months ended September 30, 2016, we received proceeds under the Master Lease Agreement of \$6.1 million. At September 30, 2016, our total outstanding liability under the Master Lease Agreement was \$10.3 million. The

average interest rate for amounts outstanding under the Master Lease agreement was approximately 3.50%.

We have accounted for the Master Lease Agreement as a financing transaction and amounts owed are included in Finance Obligations, current and non-current in the consolidated balance sheets. We recorded no gain or loss as a result of this transaction. The Master Lease Agreement allows for lease financing of up to \$20 million. Our liability under the Master Lease Agreement approximates fair value.

## Table of Contents

In connection with the Master Lease Agreement, and as long as any obligations remain outstanding under the Master Lease Agreement, we are required to maintain compliance with the same financial covenants as the Term Loan agreement with U.S. Bank described above. At September 30, 2016, we were in compliance with these financial covenants.

### U.S. Bank commercial purchasing card agreement

We have a commercial purchasing card (the "Purchasing Card") agreement with U.S. Bank. We use the Purchasing Card for business purpose purchasing and must pay it in full each month. At September 30, 2016, \$636,000 was outstanding and \$4.4 million was available under the Purchasing Card. At December 31, 2015, \$641,000 was outstanding and \$4.4 million was available under the Purchasing Card.

### Off-Balance Sheet Arrangements

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

### Critical Accounting Policies and Estimates

The preparation of our financial statements requires that we make estimates and judgments. We base these on historical experience and on other assumptions that we believe to be reasonable. Our critical accounting policies are discussed in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Annual Report on Form 10-K for the year ended December 31, 2015, and our accounting policies and use of estimates are further discussed in Note 2 to the financial statements included in this Form 10-Q and elsewhere in this Management's Discussion and Analysis of Financial Condition and Results of Operations. During Q3 2015 and Q1 2016, we acquired certain intangible assets and we used estimates in our valuations of those assets. During Q3 2016, we estimated the fair value of a cost method investment to determine if the investment was impaired. There have been no other material changes to the critical accounting policies previously disclosed in Annual Report on Form 10-K for the year ended December 31, 2015.

### Non-GAAP Financial Measures

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

### Contribution and Contribution Margin

Contribution (a non-GAAP financial measure which we reconcile below to "Gross Profit," the nearest GAAP financial measure appearing in our consolidated statement of operations) consists of gross profit less sales and marketing expense plus Club O Rewards and gift card breakage and reflects an additional way of viewing our results. Contribution margin is contribution as a percentage of total net revenue. We believe contribution and contribution margin provide management and users of the financial statements information about our ability to cover our operating costs, such as technology and general and administrative expenses, while reflecting the selling costs we incurred to generate our revenues. We recently changed this calculation to also include Club O Rewards and gift card breakage (included in Other income, net in our consolidated statement of operations). This change has been applied to all periods presented. Including these amounts in our contribution improves this measure by adding back the reductions in revenue that we recognized for Club O Rewards that have subsequently expired and for gift cards whose redemption is remote. Other income, net was \$1.3 million and \$764,000 for the three months ended September 30,

2016 and 2015, respectively, and included Club O Rewards and gift card breakage. Other income, net was \$9.4 million and \$2.5 million for the nine months ended September 30, 2016 and 2015, respectively, and included Club O Rewards and gift card breakage. Contribution and contribution margin are used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. The material limitation associated with the use of contribution is that it is an incomplete measure of profitability as it does not include all operating expenses or all non-operating income and expenses. Management compensates for these limitations when using this measure by looking at other GAAP measures, such as operating income and net income. You should review our financial statements and publicly-filed reports in their entirety and not rely on any single financial measure.

Table of Contents

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

	Three months ended				Nine months ended			
	September 30,		2015		September 30,		2015	
	2016		2015		2016		2015	
Total net revenue	\$441,564	100%	\$391,211	100%	\$1,273,781	100 %	\$1,177,568	100 %
Cost of goods sold	361,848	81.9	318,760	81.5	1,040,436	81.7%	956,023	81.2%
Gross profit	79,716	18.1	72,451	18.5	233,345	18.3%	221,545	18.8%
Less: Sales and marketing expense	34,707	7.9	30,062	7.7	99,516	7.8 %	86,121	7.3 %
Plus: Club O Rewards and gift card breakage (included in Other income, net)	4,162	0.9	1,537	0.4%	12,247	1.0 %	3,447	0.3 %
Contribution and contribution margin	\$49,171	11.1%	\$43,926	11.2%	\$146,076	11.5%	\$138,871	11.8%

## Free cash flow

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

	Nine months ended		Twelve months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net cash (used in) provided by operating activities	\$(15,439)	\$(36,400)	\$75,477	\$44,930
Expenditures for fixed assets, including internal-use software and website development	(59,382 )	(43,381 )	(75,514 )	(52,183 )
Free cash flow	\$(74,821)	\$(79,781)	\$(37 )	\$(7,253 )

## Government Regulation

Our main business is subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet, e-commerce and other services. Existing and future laws and regulations may result in increasing expense and may impede our growth. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, mobile communications, electronic device certification, electronic waste, energy consumption, environmental regulation, electronic contracts and other communications, competition, consumer protection, information reporting requirements, the design and operation of websites, and the characteristics and quality of products and services. New state tax regulations in states where we do not now collect state and local taxes may subject us to the obligation to collect and remit state and local taxes, or subject us to additional state and local sales and income taxes, or to requirements intended to assist states with their tax collection efforts. New legislation or regulations, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial



online services could result in significant additional taxes on our business. These taxes or tax collection obligations could have an adverse effect on us. Further, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements. In addition, it is not clear how existing laws governing issues such as property ownership, libel, and personal privacy apply to the Internet, e-commerce and digital content. Laws and regulations may diminish the demand for our products and services and increase our cost of doing business. Certain of our

## Table of Contents

services are subject to federal and state consumer protection laws, including laws protecting the privacy of consumer information and regulations prohibiting unfair and deceptive trade practices. In particular, under federal and state financial privacy laws and regulations, we must provide notice to consumers of our policies on sharing non-public information with third parties, advance notice of any changes to our policies and, with limited exceptions, we must give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties. Further, the growth and demand for online commerce could result in more stringent consumer protection laws that could impose additional compliance burdens on us. These consumer protection laws could result in substantial compliance costs.

In addition, the broker-dealers that we recently acquired are subject to additional extensive regulatory requirements under federal and state laws and regulations and self-regulatory organization (“SRO”) rules. Broker-dealers are subject to regulation, examination and disciplinary action by the SEC, FINRA and state securities regulators, as well as other governmental authorities and SROs with which they are registered or licensed or of which they are members. See Part II - Item 1A - “Risk Factors - We have entered into agreements to acquire registered broker-dealers, which are subject to extensive regulation.”

Our efforts to expand our sales outside of the U.S. expose us to additional U.S. and foreign laws and regulations, including but not limited to, laws and regulations relating to taxation, business licensing or certification requirements, advertising practices, online services, the use of cryptocurrency, the importation of specified or proscribed items, importation quotas, consumer protection, intellectual property rights, consumer and data protection, privacy, encryption, restrictions on pricing or discounts, and the U.S. Foreign Corrupt Practices Act and other applicable U.S. and foreign laws prohibiting corrupt payments to government officials and other third parties. Our investment in Bitt Inc. also may expose us to additional laws and regulations relating to money transmitters and money services businesses. See Part II - Item 1A - “Risk Factors - Risks Related to Our Business and Industry - Risks Relating to Certain Specific Businesses, Investments in Businesses - and Recent or Planned Changes to Our Business - Our investment in Bitt Inc. may expose us to risks under laws and regulations with which we do not have significant experience.”

### Factors that May Affect Future Results

We believe that the cash and cash equivalents currently on hand and expected cash flows from future operations will be sufficient to continue operations for at least the next twelve months. All projections of future cash needs and cash flows are subject to substantial uncertainty. See Item 1A of Part II, “Risk Factors.”

In May 2015, our Board of Directors authorized a stock repurchase program under which we may repurchase shares of our outstanding common stock for up to \$25 million at any time through December 31, 2017. To date we have not made any repurchases under this program. We periodically evaluate opportunities to sell additional equity or debt securities, obtain credit facilities, or repurchase common stock. In December 2015, the SEC declared our shelf registration statement on Form S-3 effective. Under the registration statement, we intend to offer digital, or blockchain, securities through a rights offering. Our Board of Directors set a November 10, 2016 record date for this rights offering. Any sale of additional equity or convertible debt securities could be dilutive to our stockholders. In addition, we may, from time to time, consider the acquisition of, or investment in, complementary businesses, products, services, or technologies, any of which might affect our liquidity requirements or cause us to issue additional equity or debt securities. There can be no assurance that financing arrangements will be available in amounts or on terms acceptable to us, if at all.

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described in this Form 10-Q, including the risks described in Item 1A of Part II (“Risk Factors”) of this Form 10-Q, and all other information in this Form 10-Q and in our other filings with the SEC including those we file

after we file this Form 10-Q, before deciding whether to purchase or hold our securities.

Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described under “Risk Factors” in this report could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Other than the interest rate swaps described below and elsewhere in this Quarterly Report on Form 10-Q, we do not use derivative financial instruments in our investment portfolio, and we have no foreign exchange contracts. Our financial

## Table of Contents

instruments consist of cash and cash equivalents, accounts receivable, accounts payable, current notes payable and long-term obligations. We consider investments in highly-liquid instruments with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents.

In connection with the syndicated senior secured credit facility described above, we entered into interest rate swap transactions. The swaps have an effective date of September 1, 2015 and a maturity date of October 1, 2023. The combined notional amount changes monthly beginning at approximately \$3.6 million on September 1, 2015, increasing to a maximum of approximately \$45.8 million on October 1, 2016, and decreasing thereafter to approximately \$38.2 million on October 1, 2023. The swaps effectively fix our effective interest rate on the approximate amounts expected to be outstanding from time to time on the Real Estate Loan at an annual rate of approximately 4.6%. At September 30, 2016, we had \$40.9 million outstanding under the Real Estate Loan, and the notional amount of the swaps was \$45.1 million.

We carry our interest rate swaps at fair value on our consolidated balance sheets. At September 30, 2016, we recognized swap liabilities in the amount of \$4.3 million. The change in fair value of our swaps for the nine months ended September 30, 2016 was a loss of \$1.9 million. The fair value of the swaps can be impacted by several factors including forward rates, interest rates and discount rates (see Item 1 of Part I, "Financial Statements"—Note 2. Accounting Policies, Fair value of financial instruments). Because we have designated our swaps as cash flow hedges for accounting purposes, to the extent the swaps qualify for this designation and are effective, changes in the fair value of the instruments are recognized through Other comprehensive income (loss) in our statements of comprehensive income (loss) (see Item 1 of Part I, "Financial Statements"—Note 2. Accounting Policies, Derivative financial instruments).

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

At September 30, 2016, we had \$124.5 million in cash and cash equivalents. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of \$1.2 million on our earnings or loss, or the cash flows of these instruments.

At September 30, 2016, we had assets consisting of investments in precious metals totaling \$9.7 million. Hypothetically, an increase or decrease in the market value of one hundred basis points could potentially have an estimated impact of \$97,000 on our earnings or loss, or the recorded value of these instruments. Earnings resulting from increases in the market value of precious metals would be limited to losses incurred in the same fiscal year.

At September 30, 2016, letters of credit totaling \$430,000 were outstanding under our credit facilities. Hypothetically, an increase or decrease in interest rates of one hundred basis points would have an estimated impact of \$4,300 on our earnings or loss if the letters of credit were fully drawn.

At September 30, 2016, we had cryptocurrency-denominated assets totaling \$288,000. Hypothetically, an increase or decrease in the market value of one hundred basis points could potentially have an estimated impact of \$2,880 on our earnings or loss, or the recorded value of these instruments. Reported earnings resulting from increases in the market value of cryptocurrency would be limited to their historical cost.

## ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Table of Contents

Evaluation of Disclosure Controls and Procedures

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

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

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

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Please consider the following risk factors carefully. If any one or more of the following risks were to occur, it could have a material adverse effect on our business, prospects, financial condition and results of operations, and the market price of our securities could decrease significantly. Statements below to the effect that an event could or would harm our business (or have an adverse effect on our business or similar statements) mean that the event could or would have a material adverse effect on our business, prospects, financial condition and results of operations, which in turn could or would have a material adverse effect on the market price of our securities. Although we have organized the risk factors below under headings to make them easier to read, many of the risks we face involve more than one type of risk. Consequently you should read all of the risk factors below carefully before making any decision to acquire or hold our securities.

Risks Related to Our Business and Industry - Infrastructure, Cyber Security, Data Breach and Related Risks

Our business depends on our Website, our mobile app, our network infrastructure and transaction-processing systems.

As an e-commerce company, we are completely dependent on our infrastructure and on the availability and reliability of the Internet and related systems. Any system interruption that results in the unavailability of our Website or our mobile app or reduced performance of our transaction systems could interrupt or substantially reduce our ability to conduct our business. If our Website or our mobile app or any of the many systems necessary to support the operation of either of them fail at any time to operate well and quickly enough to satisfy a potential customer, we may quickly lose the opportunity to convert that potential customer into an actual or regular customer. We have experienced periodic systems interruptions due to server failure, power failure and intentional cyber attacks in the past, which we expect will continue to occur from time to time. We have also experienced and may continue to experience temporary capacity constraints due to sharply increased traffic during sales or other promotions and during the holiday shopping season. Capacity constraints can cause system disruptions, slower response times, delayed page presentation, degradation in levels of customer service and other problems. In the past we have also experienced difficulties with our infrastructure upgrades. Our business and the various technologies necessary to support our business change rapidly, and we must upgrade our infrastructure virtually continuously. Any future difficulties with our transaction processing systems or difficulties upgrading, expanding or integrating aspects of our systems may cause system disruptions, slower response times, and degradation in levels of customer service, additional expense, impaired quality and speed of order fulfillment or other problems. The occurrence of any of the foregoing could have a material adverse effect on our business.

If the facility where substantially all of our computer and communications hardware is located fails, our business, prospects, financial condition and results of operations could be harmed.

If the facility where substantially all of our computer and communications hardware is located fails, or if we suffer an interruption or degradation of services at the facility for any reason, our business could be harmed. Our success, and in particular, our ability to successfully receive and fulfill orders and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications systems. Substantially all

of our computer and communications hardware is located at a single facility. In the event of an earthquake or other local disaster, or any other cause of interruption of service, both our primary and back-up sites could be adversely affected. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, cyber-attacks, acts of war, break-ins, earthquake and similar events. In the event of a failure of our primary facility, the failover to our back-up facility would take at least several hours, during which time our Website would be completely shut down. Our back-up facility is not adequate to support sales at a high level. The back-up facility may not process effectively during time of higher traffic to our Website and may process transactions more slowly and may not support all of the functionality of our primary site. These limitations could have an adverse effect on our conversion rate and sales. Our disaster recovery plan may be inadequate, and we do not carry business interruption insurance sufficient to compensate us for the losses that could occur. Our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, the occurrence of any of which could



## Table of Contents

lead to interruptions, delays, loss of critical data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could have a material adverse effect on our business.

We are subject to cyber security risks and risks of data loss or other security breaches, and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents.

Our business is entirely dependent on the secure operation of our Website and systems as well as the operation of the Internet generally. Our business involves the storage and transmission of users' proprietary information, and security breaches could expose us to a risk of loss or misuse of this information, and to resulting claims and litigation. We have been subjected to a variety of cyber attacks, including denial of service attacks in which attackers attempt to block customers' access to our Website. If we are unable to defend against a denial of service attack or other types of attacks for any significant period, we could sustain substantial revenue loss from lost sales and customer dissatisfaction. We may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. Cyber-attacks may target us, our customers, our suppliers, banks, credit card processors, delivery services, e-commerce in general or the communication infrastructure on which we depend. If an actual or perceived attack or breach of our security occurs, customer and/or supplier perception of the effectiveness of our security measures could be harmed and we could lose customers, suppliers or both. Actual or anticipated attacks and risks may cause us to incur substantial and increasing costs, including costs to deploy additional personnel and protection technologies, train employees, and engage third party experts and consultants. The occurrence of any of the foregoing could have a material adverse effect on our business.

A person who is able to circumvent our security measures might be able to misappropriate our or our users' proprietary information, cause interruption in our operations, damage our computers or those of our users, or otherwise damage our reputation and business. Any compromise of our security could result in a violation of applicable privacy and other laws, significant legal and financial exposure, damage to our reputation, and a loss of confidence in our security measures, which could have a material adverse effect on our business.

Our dependence on credit or debit card payments increases our risks.

Most of our customers use credit cards to pay for their purchases. Under payment card rules and our contracts with our card processors, if there is a breach of payment card information that we store, we could be liable to the payment card issuing banks for their cost of issuing new cards and related expenses. In addition, if we fail to follow payment card industry security standards, even if there is no compromise of customer information, we could incur significant fines, higher transaction costs or lose our ability to give customers the option of using payment cards. If we were unable to accept payment cards, it would have a material adverse effect on our business.

Cyber-attacks affecting our partners, suppliers, delivery services or other service providers could adversely affect us.

We depend on our partners to provide a large portion of the product selection we offer and on vendors for the products we purchase and offer in our direct business. We also depend on delivery services to deliver products, and on other service providers, including suppliers of services which support Website operations, including payment systems, customer service support, and communications. Cyber-attacks affecting our delivery services or any of our most significant suppliers or affecting a significant number of our suppliers of products or services could result in our inability to source product or fulfill orders, our customers' or suppliers' inability to contact us or access our Website or call centers or chat lines, or the compromise of our customers' confidential data. The occurrence of any of the foregoing could have a material adverse effect on our business.

Our expansion into financial technology businesses and our acquisitions of registered broker dealers and related businesses increases our infrastructure, cyber security, data breach and related risks.

As we have expanded into financial technology businesses and have acquired registered broker dealers and related businesses, our infrastructure, cyber security, data breach and related risks have increased. See “Risks Related to Our Business and Industry - Risks Relating to Certain Specific Businesses, Investments in Businesses and Recent or Planned Changes to Our Business.”

#### Risks Related to Our Business and Industry - Competition

We face intense competition and may not be able to compete successfully against existing or future competitors.

## Table of Contents

The online retail market is rapidly evolving and intensely competitive. Barriers to entry are minimal, and current and new competitors can launch new websites at a relatively low cost. We currently compete with numerous competitors, including:

- online retailers with or without discount departments, including AliExpress (part of the Alibaba Group), Amazon.com, eBay, and Rakuten.com (formerly Buy.com);
- online specialty retailers such as Blue Nile, Bluefly, Jet.com, Wayfair, Zappos.com, and Zulily;
- private sale sites such as Groupon, Living Social and Rue La La;
- furniture specialists including Ashley Furniture, Bob's Discount Furniture, Havertys, Raymour & Flanigan and Rooms To Go;
- traditional general merchandise and specialty retailers and liquidators including Barnes and Noble, Bed, Bath & Beyond, Best Buy, Costco Wholesale Corporation, Crate and Barrel, Ethan Allen, Gilt, Home Depot, HomeGoods, Hudson's Bay Company, IKEA, J.C. Penny Company, Kirkland's, Kohl's, Lands' End, Lowes, Macy's, Nordstrom, Pier 1 Imports, Pottery Barn, Restoration Hardware, Ross Stores, Saks Fifth Avenue, Sears Holding Corporation, T.J. Maxx, Target Corporation, Wal-Mart and Williams-Sonoma, all of which also have an online presence; and
- liquidation e-tailers such as SmartBargains.

The intense and increasing competition we face from a wide variety of competitors, many of which have substantially greater resources than we do, and some of which are willing to incur losses in order to increase revenues, may result in our pricing of products or services below prices at which we can make a profit, may cause us to lose sales entirely, and may have a material adverse effect on our business.

Our competitors are rapidly developing a wide variety of services and other offerings, and we may be unable to provide more competitive offerings.

The online retail market has become far more competitive as traditional and online retailers continue to develop and improve services that compete with our services. Many traditional manufacturers and retailers have added or improved their e-commerce offerings, and we expect that more will do so and that they will all continue to improve their offerings. Traditional and predominantly online retailers may create proprietary, store-based distribution and returns channels that we may be unable to match, and may also be able to create their own traditional distribution and delivery services. Amazon continues to open additional fulfillment centers and to increase its same-day delivery capabilities in an increasing number of metro areas as well as one and two-hour delivery capability on certain items in an increasing number of metro areas, and staffed pickup locations in certain high-density locations. Competitive pressures, including same-day and one and two-hour delivery capabilities, from Amazon and from any of our other competitors, many of whom have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do, affect us and could have a material adverse effect on our business.

In addition to the types of retailers described above, we are competing with specialty firms in several areas, many of which focus exclusively or primarily on the business in which we are competing.

In addition to the types of retailers described above, in many areas we face competition from numerous other businesses, many of which may specialize in the type of business in which we are competing. Our furniture offerings compete with more than 100 online retail furniture websites, in addition to many more traditional furniture retail specialists. We face the risk that potential furniture and other customers will choose traditional retailers where they can physically examine products prior to purchase. Our Supplier Oasis service faces substantial competition from third party logistics providers as well as from Amazon and eBay and other e-commerce service providers having substantially greater experience and resources than we have. We are currently offering insurance products, and as such face competition from small and large established businesses with substantially more experience. An inability to

compete in these areas could have a material adverse effect on our business.

Our majority-owned subsidiary tØ.com is competing with a rapidly-growing group of companies in the financial industry as well as new entrants with significant resources from venture capital firms and other funding sources.

Our majority-owned subsidiary tØ.com, Inc. (formerly Medici, Inc.) is competing against a variety of companies with substantially greater financial resources and experience in financial technology. The number of competitors in this area and the resources being devoted to the area by competitors are growing rapidly. We may be unable to compete successfully against these competitors or others that may not yet have publicly announced their business plans in this area, which could have a material adverse effect on our business.

Table of Contents

Risks Related to Our Business and Industry - Dependence on Third Parties

As an e-commerce company, we depend on a number of other companies to perform functions critical to our ability to deliver products to our customers and to perform many of the related functions.

Our goal is to provide our customers with quality products at the best prices possible, while also providing our customers with a very high level of service. In our efforts to accomplish this, we depend on a number of other companies to perform functions critical to our ability to deliver products to our customers and to perform many of the related functions. Our business model involves a number of material risks related to our dependence on other companies, as described below.

We depend on our relationships with independent partners for substantially all of the products that we offer for sale on our Website. If we fail to maintain these relationships, our business will suffer.

At September 30, 2016, we had relationships with approximately 4,000 independent partners whose products we offer for sale on our Website. Sales through our partners accounted for approximately 94% of our net revenues for the three and nine months ended September 30, 2016. If we do not maintain our existing relationships or build new relationships with partners on acceptable commercial terms, we may not be able to maintain a broad selection of merchandise, and our business and prospects would suffer severely. Our agreements with partners are generally terminable at will by either party upon short notice. Our failure to maintain, replace or expand these relationships could have a material adverse effect on our business.

We depend on our partners to perform critical services regarding the products that we offer.

In general, we agree to offer the partners' products on our Website and these partners agree to conduct a number of other traditional retail operations such as maintaining inventory, preparing merchandise for shipment to our customers and delivering purchased merchandise on a timely basis. We have no ability to ensure that these third parties will continue to perform these services to our satisfaction or on terms we or our customers consider reasonable. In addition, because we do not take possession of these fulfillment partners' products (other than on the return of such products), we are generally unable to fulfill these traditional retail operations ourselves. If our customers become dissatisfied with the services provided by these third parties, our business and reputation and brand would suffer, which could have a material adverse effect on our business.

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

We rely upon third party fulfillment and delivery providers for the shipment of products to customers. We cannot be sure that these relationships will continue on terms we find acceptable, or at all. Increases in shipping or fulfillment costs or delivery times, particularly during the holiday season, could harm our business. For example, in June 2015, UPS announced that it would discontinue offering discounts for its customers on oversize packages during the holiday season. Another example is Hanjin Shipping, which filed for bankruptcy on August 31, 2016, resulting in shipping delays for several of our large volume partners and resulting in shipping rate increases imposed by Hanjin Shipping's competitors. If our relationships with these third parties are terminated or impaired or if these third parties are unable to deliver products for us on terms we find acceptable, whether as a result of adverse weather conditions, labor shortage, slow down or stoppage, deteriorating financial or business condition, fulfillment facilities impairment, terrorist attacks, cyber-attacks, Internet or other infrastructure or communications impairment, natural disasters,

unexpectedly high shipping volumes, an increase in shipping rates, or for any other reason, we may be required to use alternative fulfillment service providers or carriers for the shipment of products to our customers, if such alternatives were available. If under such circumstances there were no alternatives available, we may be forced to accept fulfillment services which may have an adverse effect on our customers' satisfaction with us, which may materially increase our shipping costs, or both. Conditions such as adverse weather or natural disasters can prevent any carrier from performing its delivery services, which can also have an adverse effect on our customers' satisfaction with us. In any of these circumstances, we may be unable to engage alternative fulfillment services or carriers on a timely basis, upon terms we find acceptable, or at all. Changing fulfillment services or carriers, the absence of fulfillment services or carrier availability, or increases in the shipping rates of our current fulfillment service or carrier providers could have a material adverse effect on our business.

We depend upon our credit card processors and payment card associations.

## Table of Contents

Our customers primarily use credit cards to buy from us. We are dependent upon our credit card processors to process the sales transactions and remit the proceeds to us. The credit card processors have the right to withhold funds otherwise payable to us to establish or increase reserves based on their assessment of the inherent risks of credit card processing and their assessment of the risks of processing our customers' credit cards at any time, and have done so from time to time in the past. We are also subject to payment card associations' operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments. In addition, events affecting our payment card processors, including cyber-attacks, Internet or other infrastructure or communications impairment or other events that could interrupt the normal operation of the payment card processors, could have a material adverse effect on our business.

We rely upon paid and natural search engines including Google, Bing, and Yahoo! to rank our product offerings.

We rely on paid and natural search engines to attract consumer interest in our product offerings. Potential and existing customers use search engines provided by search engine companies, including, but not limited to, Google, Bing, and Yahoo! See "Risks Related to Our Business and Industry - Marketing Risks - We rely upon paid and natural search engines including Google, Bing, and Yahoo! to rank our product offerings. Our financial results may suffer if search engines change their ranking algorithms and our product offerings are ranked lower, and we may at times be subject to ranking penalties if the operators of search engines believe we are not in compliance with their guidelines," below.

Risks associated with the suppliers from whom our products are sourced and the safety of those products could adversely affect our financial performance.

Global sourcing of many of the products we sell is an important aspect of our business. We depend on our ability to access products from qualified suppliers in a timely and efficient manner. Our ability to find qualified suppliers who meet our standards and supply products in a timely and efficient manner is a significant challenge, especially with respect to goods sourced from outside the U.S. Political and economic instability, the financial stability of suppliers, suppliers' ability to meet our standards, labor problems experienced by our suppliers, the availability of raw materials, merchandise quality issues, currency exchange rates, transport availability and cost, transport security, inflation, and other factors relating to the suppliers and the countries in which they are located or from which they may source materials or products are beyond our control. We also largely rely on our suppliers' representations of product content and quality. Concerns regarding product content or quality, or the safety of products that we source from our suppliers, could cause shoppers to avoid purchasing certain products from us, or to seek alternative sources of supply for all of their needs, even if the basis for the concern is outside of our control. Any lost confidence on the part of our customers would be difficult and costly to reestablish. As such, any issue regarding the safety of any items we sell, regardless of the cause, could adversely affect our financial performance. Further, if any product we sell were to cause physical injury or injury to property, the injured party or parties might bring claims against us. Any indemnity agreement we may have with the supplier may be inadequate or inapplicable, and any insurance coverage we may carry may not be adequate to cover claims that could be asserted. Even unsuccessful claims could result in the expenditure of funds and management time and could have a negative impact on our business. The occurrence of any of the foregoing could have a material adverse effect on our business.

We depend upon third parties for all or substantially all of the services we offer.

In addition to the many third parties we rely on in connection with our sale and the delivery of products to our customers, we depend upon third parties for all or substantially all of the services we offer, including our insurance offerings, our consumer financing offerings, our new and used car listings, our car-related services and our pet

adoption services. Services offerings are inherently different from product offerings, and we may encounter difficulties with our services offerings that may be different from the types of issues we face with our product offerings. Any such difficulties could have a material adverse effect on our business.

Manufacturers may refuse to sell to us or through our site.

We rely upon our partners and other suppliers for the product offerings sold on our Website and other products and services we use to run our business. Our ability to retain or attract new partners and other suppliers may depend in part on our financial performance. Poor financial performance could result in suppliers choosing to limit or suspend doing business with us or require us to prepay for our purchases. Further, some manufacturers are unwilling to offer products for sale on the Internet or



## Table of Contents

on sites like ours. Our inability to source and offer popular products could be a significant problem for us and could have a material adverse effect on our business.

### Risks Related to Our Business and Industry - Marketing Risks

Our business depends on effective marketing, and we change our advertising and marketing programs often.

We depend on effective marketing and high customer traffic. We have many initiatives in this area, and often change our advertising and marketing programs. The results of our advertising and marketing programs vary. We constantly evaluate where we spend marketing dollars. From time to time, certain competitors may bid up the cost of certain marketing channels, such as paid keywords. At such times, we may reduce the amounts we spend in those marketing channels, which may lead to decreased visitors to our site for a time. If we are unable to develop, implement and maintain effective and efficient advertising and marketing programs, it could have a material adverse effect on our business.

We rely upon paid and natural search engines including Google, Bing, and Yahoo! to rank our product offerings. Our financial results may suffer if search engines change their ranking algorithms and our product offerings are ranked lower, and we may at times be subject to ranking penalties if the operators of search engines believe we are not in compliance with their guidelines.

We rely on paid and natural search engines to attract consumer interest in our product offerings. Potential and existing customers use search engines provided by search engine companies, including, but not limited to, Google, Bing, and Yahoo!, which use algorithms and other devices to provide users a natural ranked listing of relevant Internet sites matching a user's search criteria and specifications. Generally, Internet sites ranked higher in the paid and natural search results attract the largest visitor share among similar Internet sites, and often benefit from increased sales. Natural search engine algorithms use information available throughout the Internet, including information available on our site. Search engine companies change their natural search engine algorithms periodically, and our ranking in natural searches may be adversely affected by those changes. When this occurs, our financial results may suffer from reduced revenues and from increased marketing expenses, as we believe we experienced during 2016 and some prior periods, as we seek to replace lost revenues by using other sources.

Rules and guidelines of these natural search engine companies govern our participation on their sites and how we share relevant Internet information that may be considered or incorporated into the algorithms used by these sites. If these rules and guidelines change, or if we fail to present, or improperly present, our site information for use by natural search engine companies, or if any of these natural search engine companies determine that we have violated their rules or guidelines, as Google did in 2011, or if others improperly present our site information to these search engine companies, we may fail to achieve an optimum ranking in natural search engine listing results, or we may be penalized in a way that could harm our business.

In addition, large marketplace websites and sites which aggregate marketplace sellers with a large product selection are becoming increasingly popular, and we may not be able to place our products on these sites to take advantage of their internal search platforms. Further, some shoppers may begin their searches at a competitor's website, and may not utilize traditional search engines at all. Our inability to place products on or access these sites may have a material adverse effect on our business.

Our business relies heavily on email, and reduced utilization of email in general and any restrictions on the sending of commercial email could have a material adverse effect our business.

We depend on email to promote our site and offerings. We provide daily emails to potential customers about our offerings, and email promotions are an important part of our marketing and help generate a substantial portion of our net revenue. If a significant portion of our target customers no longer utilize email, or if we are unable to effectively deliver email to our potential customers, our business, financial condition and operating results would be harmed. Changes in webmail applications' organization or prioritization of email could reduce the number of potential customers opening our email. For example, email inbox organization or prioritization features may result in our emails being delivered in a less prominent location in a subscriber's inbox or viewed as "spam" by our subscribers and may reduce the likelihood of that subscriber opening our emails. Anything, including legal or regulatory restrictions, that blocks, imposes restrictions on or imposes charges for the delivery of email could also harm our business. We also rely on social networking messaging services to send communications and to encourage customers to send communications. Changes to the terms of these social networking services to limit promotional communications, any restrictions that would limit our ability or our customers' ability to send communications through their services, disruptions or downtime experienced by these social networking services or decline in

## Table of Contents

the use of or engagement with social networking services by customers and potential customers could have a material adverse effect on our business.

We are experimenting with reductions in the number of coupons we offer to our customers and with increases in the amount of Club O Rewards we offer to Club O members, which may have adversely affected our revenue growth and may continue to do so.

Although our business has historically relied heavily on coupons to generate sales, we are experimenting with reductions in our coupon marketing and are attempting to substitute increased Club O Rewards for a portion of our coupon marketing. We believe that the changes we have made recently have adversely affected our revenue growth. We are continuing to attempt to increase the attractiveness of our Club O offerings, but have not yet achieved the results we are seeking, and there can be no assurance that we will be able to do so. If we are unable to generate sales from Club O members at rates equal to or better than the rates we were generating through our coupon marketing to non-Club O members, our revenue growth could be adversely affected or reversed, and our business, financial condition and operating results could be materially adversely affected.

### Risks Related to Our Business and Industry - Fraud Risks

Credit card fraud and our response to it could adversely affect our business.

We routinely receive orders placed with fraudulent credit card data. If we fail to adequately control fraudulent credit card transactions it could reduce our net revenues and our gross profit or cause credit card or payment system companies to disallow their cards' use for customer payments on our website. We may suffer losses as a result of orders placed with fraudulent credit card data even if the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we do not obtain a cardholder's signature. If we are unable to detect or control credit card fraud, claims against us for these transactions could harm our business, prospects, financial condition and results of operation. Further, to the extent that our efforts to prevent fraudulent orders result in our inadvertent refusal to fill legitimate orders, we would lose the benefit of legitimate potential sales and risk the alienation of legitimate customers. The occurrence of any of the foregoing could have a material adverse effect on our business.

Implementation of the EMV credit card standards in the U.S. during 2015 may increase fraud efforts against U.S. online retailers, including us.

Credit card issuers in the United States began replacing traditional credit cards with credit cards meeting the EMV (Europay, MasterCard and Visa) standards during 2015. Cards meeting the EMV standards contain a chip which makes the cards more difficult to counterfeit than the traditional magnetic stripe-only cards widely used in the U.S. However, to the extent that the EMV standards make card-duplication fraud more difficult, the new standards may drive more fraud efforts against online retailers, including us. Consequently, as an online retailer, we may be subject to increasing levels of fraudulent orders and other types of criminal activities. Increased levels of fraud and other criminal activities could have a material adverse effect on our business.

### Risks Related to Our Business and Industry - Certain Specific Risks

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

We have a history of losses, and we may incur operating and net losses in the foreseeable future. At September 30, 2016, our accumulated deficit was \$157.0 million. We need to generate significant revenues to maintain profitability, and we may not be able to do so. Although we have generated positive net income in recent years, we incurred a net

loss for 2011, and net losses for Q3 2015, Q2 2016 and our most recent ended Q3 2016. We may be unable to maintain profitability in the future. If our revenues grow more slowly than we anticipate or decline, or if our expenses exceed our expectations, our financial results would be harmed and our business, prospects, financial condition and results of operations could fall below the expectations of public market analysts and investors. The occurrence of any of the foregoing could have a material adverse effect on our business.

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

## Table of Contents

The rapidly evolving nature of our industry and the constantly evolving nature of our business make forecasting operating results difficult. We periodically implement large, complex and expensive infrastructure upgrades in order to increase our ability to handle larger volumes of sales and to develop or increase our ability to perform a variety of analytical procedures relating to our business. We are continuing to upgrade and further expand these and other components of our infrastructure, and are in the process of integrating infrastructure relating to the fintech company and broker-dealers we recently acquired. In the past, we have experienced difficulties with upgrades of our infrastructure, and have incurred increased expenses as a result of these difficulties. As a result of expenditures on our infrastructure and headquarters, our ability to reduce our expenditures is and will be limited. Therefore, any significant shortfall in the revenues for which we have built and are continuing to build our business could have a material adverse effect on our business.

Natural disasters, pandemics, and geo-political events could adversely affect our business.

Natural disasters, including hurricanes, cyclones, typhoons, tropical storms, floods, earthquakes and tsunamis, weather conditions, including winter storms, droughts and tornados, whether as a result of climate change or otherwise, pandemics, and geo-political events, including civil unrest or terrorist attacks, that affect us or our delivery services, suppliers, credit card processors or other service providers could adversely affect our business.

Our insurance coverage and indemnity rights may not adequately protect us against loss.

The types, coverage, or the amounts of any insurance coverage we may carry from time to time may not be adequate to compensate us for any losses we may actually incur in the operation of our business. Further, any insurance we may desire to purchase may not be available to us on terms we find acceptable or at all. We are not indemnified by all of our suppliers, and any indemnification rights we may have may not be enforceable or adequate to cover actual losses we may incur as a result of our sales of their products. Actual losses for which we are not insured or indemnified, or which exceed our insurance coverage or the capacity of our indemnitors or our ability to enforce our indemnity agreements, could have a material adverse effect on our business.

We face risks relating to our inventory.

In our direct business, we sell merchandise that we have purchased and hold in inventory. We assume the risks of inventory damage, theft and obsolescence, as well as risks of price erosion for these products. These risks are especially significant because some of the merchandise we sell is characterized by seasonal trends, fashion trends, rapid technological change, obsolescence and price erosion, and because we sometimes make large purchases of particular types of inventory. Subject to our returns policies, we accept returns of products sold through our partners as well as products we sell in our direct business, and we have the risk of reselling the returned products. In the past we have recorded charges for obsolete inventory and have had to sell certain merchandise at a discount or loss. To the extent that we rely on purchased inventory, our success will depend on our ability to sell our inventory rapidly, the ability of our buying staff to purchase inventory at attractive prices relative to its resale value and our ability to manage customer returns and other costs. If we are unsuccessful in any of these areas, we may be forced to sell our inventory at a discount or loss. Further, we purchase some of our inventory from foreign suppliers and pay for inventory with U.S. dollars. If the dollar weakens with respect to foreign currencies, foreign suppliers may require us to pay higher prices for products, which could negatively affect our profit margins. The occurrence of any of the foregoing could have a material adverse effect on our business.

If we do not successfully optimize and operate our warehouse and customer service operations, our business could be harmed.

We have expanded, contracted and otherwise modified our warehouse and customer service operations from time to time in the past, and expect that we will continue to do so. We also contract with third parties to receive returns and process orders. If we or our third party providers do not successfully optimize and operate our warehouse and customer service operations, it could significantly limit our ability to meet customer demand, customer shipping or return time expectations, or result in excessive costs and expenses for the size of our business. Because it is difficult to predict demand, we may not manage our facilities in an optimal way, which may result in excess or insufficient inventory or warehousing capacity. We may also fail to staff our fulfillment and customer service centers at optimal levels. Our failure to do so could negatively impact our operating results and customer experience, and could have a material adverse effect on our business.

The seasonality of our business places increased strain on our operations.

## Table of Contents

A disproportionate amount of our sales normally occur during our fourth quarter. If we do not stock or are otherwise unable to source products sufficient to meet customer demand, our business would be adversely affected. If we liquidate products, as we have in the past, we may be required to take significant inventory markdowns or write-offs, which could reduce gross profits. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. If too many customers access our Website within a short period of time due to increased holiday demand, we may experience system interruptions that make our Website unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. In addition, we may be unable to adequately staff our fulfillment and customer service centers during peak periods, and delivery services and other fulfillment companies and customer service providers may be unable to meet the seasonal demand. The occurrence of any of the foregoing could have a material adverse effect on our business.

Significant merchandise returns could harm our business.

We allow our customers to return products, subject to our returns policies. If merchandise returns are high, our business, prospects, financial condition and results of operations could be harmed. Further, we modify our policies relating to returns from time to time, and policies intended to reduce the number of product returns may result in customer dissatisfaction and/or fewer repeat customers. The occurrence of any of the foregoing could have a material adverse effect on our business.

Our pricing strategy may not meet customers' price expectations or result in net income.

Demand for our products is generally highly sensitive to price. Our pricing strategies have had, and may continue to have, a significant impact on our net sales and net income. We often offer discounted prices, and free or discounted shipping as a means of attracting customers and encouraging repeat purchases. Such offers and discounts reduce our margins. In addition, our competitors' pricing and marketing strategies are beyond our control and can significantly affect the results of our pricing strategies. If we fail to meet our customers' price expectations, or if we are unable to compete effectively with our competitors when they engage in aggressive pricing strategies or other competitive activities, it could have a material adverse effect on our business.

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

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

Changes in management roles and responsibilities, the loss of key personnel, or any inability to attract and retain additional personnel could affect our ability to successfully grow our business.

Our performance is substantially dependent on the continued services and on the performance of our senior management and other key personnel. Our performance also depends on our ability to retain and motivate our officers and key employees. Changes in the roles and responsibilities of certain members of management or the loss of the

services of any of our executive officers or other key employees for any reason could harm our business. Occasionally, members of senior management or key employees may find it necessary to take a leave of absence due to medical or other causes. In early 2013 our Chief Executive Officer and then Chairman of the Board, Dr. Patrick M. Byrne, took a two-month personal leave of absence for medical reasons, and in April 2016 he took a three-month personal leave of absence for medical reasons. Dr. Byrne returned to our Board of Directors in June 2016 and resumed his position as CEO in July 2016. Leaves of absence for temporary or extended periods may harm our business. We do not have employment agreements with any of our key personnel and we do not maintain “key person” life insurance policies. Our future success also depends on our ability to identify, attract, hire, train, retain and motivate other highly-skilled technical, managerial, editorial, merchandising, marketing and customer service personnel. Competition for such personnel is intense. Our failure to retain and attract the necessary technical, managerial, editorial, merchandising, marketing, and customer service personnel could have a material adverse effect on our business. If



## Table of Contents

any of our senior executives leaves or takes a leave of absence and is unable to return to work on a full-time basis or at all, it could have a material adverse effect on our business.

In order to obtain future revenue growth and sustain profitability, we must attract and retain customers on cost-effective terms.

Our success depends on our ability to attract and retain customers on cost-effective terms. We have relationships with online services, search engines, affiliate marketing websites, directories and other website and e-commerce businesses to provide content, advertising banners and other links that direct customers to our Website. We rely on these relationships as significant sources of traffic to our Website and to generate new customers. In the past we have terminated affiliate marketing websites as a result of efforts by certain states to require us to collect sales taxes based on the presence of those third party Internet advertising affiliates in those states, and we are likely to do so again in the future if necessary. If we are unable to develop or maintain these relationships, or develop and maintain new relationships for newly developed and necessary marketing services on acceptable terms, our ability to attract new customers and our financial condition would suffer. In addition, certain of our online marketing agreements may require us to pay upfront fees and make other payments prior to the realization of the sales, if any, associated with those payments. Current or future relationships or agreements may fail to produce the sales that we anticipate. We periodically conduct television and radio branding and advertising campaigns. Such campaigns are expensive and may not result in the cost-effective acquisition of customers. Other means of utilizing social media campaigns to attract or retain customers are expensive and may not result in cost-effective acquisition or retention of customers. The occurrence of any of the foregoing risks or our inability to attract and retain customers on cost-effective terms could have a material adverse effect on our business.

Mobile commerce and our Club O offerings are becoming increasingly significant to us.

Mobile commerce and our Club O offerings are becoming increasingly significant to us. Customers who use mobile devices and customers who join Club O may behave differently from our other customers. For example, the conversion rate of purchases from mobile devices is lower than from other sources. If our mobile customers or our Club O customers are less profitable to us than our other customers, it could have a material adverse effect on our business.

## Risks Related to Our Business and Industry - Tax and Regulatory Risks

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

We do not currently collect sales or other similar taxes on sales of goods into states where we have no duty to do so under federal court decisions construing applicable constitutional law. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us because we are engaged in online commerce, even though to do so would be contrary to existing court decisions. The future location of our fulfillment or customer service centers networks, or any other operation, service contracts with third parties located in another state, channel distribution arrangements or other agreements with third party sellers, or any act that may be deemed by a state to have established a physical presence in states where we are not now present, may result in additional sales and other tax obligations. New York and other states have passed so-called "Internet affiliate advertising" statutes, which require a remote seller, regardless of whether it has any physical presence in the state, to collect state sales tax if the remote seller contracted for advertising services with an Internet advertiser in that state. In New York and states passing similar laws, we have terminated our use of locally based Internet advertisers. Many other states currently have passed similar laws and others have legislative proposals under consideration. We may discontinue valuable marketing through the use of

affiliates based in those states, or we may begin to collect taxes in those states. In either event, or if one or more states or any foreign country where we do not or did not collect sales or other taxes successfully asserts that we should do so or have done so, it could have a material adverse effect on our business.

In 2013 the United States Senate passed the Marketplace Fairness Act of 2013 (“MFA”), but it failed to pass in the House of Representatives. Efforts continue to enact similar legislation, which would permit qualifying states to force remote sellers like us to collect taxes in states where we have no physical presence. The enactment of legislation similar to the MFA could have a material adverse effect on our business.

Other states have enacted forms of economic taxes to which we may be subject. We have been subject to and in the past contested an audit by one such state of an economic tax assessment and settled the audit demand by payment of a

Table of Contents

diminished assessment without penalty or interest. In Q3 2015, we received a Tax Assessment from the Department of Revenue of the State of Washington asserting that we had nexus with Washington during the period January 1, 2008 to May 31, 2015 and assessing approximately \$31.5 million in taxes, interest, and/or penalties asserted to be due, subject to future field verification by the Department of Revenue, for the period. We also recently received an additional Tax Assessment for the period of June 2015 through November 2015 in the amount of approximately \$2.5 million in taxes, interest and/or penalties. If we were ultimately held liable for all or substantially all of the amounts assessed against us by the Washington Department of Revenue, or for any large claims by any other states or their revenue departments, it would have a material adverse effect on our business.

Several other states have enacted laws requiring remote vendors to notify resident purchasers in those states of their obligation to pay a use tax on their purchases and, in some instances, to report untaxed purchases to the state tax authorities. Other states have enacted legislation to require retailers without a physical presence in the state to collect and remit state sales taxes if they engage in any activity in connection with the selling, leasing or delivery of tangible personal property or taxable services within the state. More states may enact these laws, or other laws to force or encourage through economic pressures remote retailers to collect and remit sales tax. Such laws could harm our business by imposing unreasonable notice burdens upon us, by interposing burdensome transaction notices that negatively affect conversion, or by discouraging customer purchases by requiring detailed purchase reporting. The occurrence of any of the foregoing could have a material adverse effect on our business.

Economic pressure on states could harm our business.

Economic circumstances affecting many states have increased the pressures on state legislatures and agencies to find ways to increase state revenues. States may continue to increase sales and use tax rates, create new tax laws covering previously untaxed activities, increase existing license fees or create new fees, any or all of which may directly or indirectly harm our business. Similarly, administrative agencies may apply more rigorous enforcement efforts or take aggressive positions respecting the laws they administer, especially if the laws permit the imposition of monetary penalties and fines which either the state or the administrative agency may use to balance their budgets or otherwise fund operations. The occurrence of any of the foregoing could have a material adverse effect on our business.

Existing or future government regulation could harm our business.

We are subject to regulation at the federal, state and international levels, including regulation relating to privacy, security, retention, transfer and use of personal user information and telemarketing laws. Increasing regulation, along with increased governmental or private enforcement, may increase the cost of our business. Compliance with existing and new privacy and security laws may be difficult and costly and may further restrict our ability to collect demographic and personal information from users, which could harm our marketing efforts, and could require us to implement new and potentially costly processes, procedures and/or protective measures. The expansion of these and other laws, both in terms of their number and their applicability to the Internet could also harm our business. Many laws, adopted prior to the advent of the Internet, do not contemplate or address the unique issues raised thereby. Consequently, courts or regulators may apply these laws to Internet commerce in ways that may present difficult or impossible compliance challenges. Laws that do reference the Internet generally remain subject to interpretation by the courts and their applicability and reach are therefore not always clear. Moreover, Internet advances and innovations may result in new questions about the applicability and reach of these laws. Additionally, laws governing the permissible contents of products may adversely affect us, and we are subject to federal and state consumer laws, including those governing advertising, product labeling, product content requirements and product safety. The laws may cause us to incur losses for any non-compliant items in our inventory, or which we may previously have sold. We may be subject to claims related to personal injury, death, environmental or property damage. We have in the past and may from time to time be required to participate in product recalls. We may incur expense in connection with any of the foregoing or other matters or actions which may not be covered, in whole, in part or at all, by any liability

insurance we may carry. These current and future laws and regulations could have a material adverse effect on our business.

Public statements we or our Chief Executive Officer, Patrick M. Byrne, have made or may make in the future may antagonize regulatory officials or others.

We and our Chief Executive Officer, Dr. Patrick M. Byrne, have from time to time made public statements regarding our or his beliefs about matters of public interest, including statements regarding naked short selling and regulatory capture. Some of those public statements have been critical of the Securities and Exchange Commission and other regulatory agencies. These public statements may have consequences for us, whether as a result of increased regulatory scrutiny or otherwise.

## Table of Contents

Additionally, other officers may make public statements that could have adverse consequences and these statements could have a material adverse effect on our business.

### Risks Related to Our Business and Industry - Macroeconomic Risks

Economic factors, including our increasing exposure to the U.S. housing industry, may adversely affect our financial performance.

Economic conditions may adversely affect our financial performance. In the United States, weakness in the housing market, changes in interest rates, changes in fuel and other energy costs, inflation or deflation or expectations of either inflation or deflation, actual or anticipated levels of unemployment, unavailability or limitations of consumer credit, higher consumer debt levels or efforts by consumers to reduce debt levels, higher tax rates and other changes in tax laws, overall economic slowdown, changes in consumer desires affecting demand for the products and services we sell and other economic factors could adversely affect consumer demand for the products and services we sell. Any of these factors may change the mix of products we sell to a mix with a lower average gross margin and/or result in slower inventory turnover and/or greater markdowns on inventory. Higher interest rates, transportation costs, inflation, higher costs of labor, insurance and healthcare, foreign exchange rates fluctuations, higher tax rates and other changes in tax laws, changes in other laws and regulations and other economic factors in the United States may increase our cost of sales and operating, may increase our selling, general and administrative expenses, and may otherwise adversely affect our operations and operating results. These factors may affect not only our operations, but also the operations of suppliers from whom we purchase goods, which may also result in increases in the cost to us of the goods and services we sell. The occurrence of any of the foregoing could have a material adverse effect on our business.

Over the last few years the percentage of our sales from home and garden products has increased substantially. We believe that our sales of home and garden products are affected by the strength of the U.S. housing industry, and that downturns in the U.S. housing industry could have a material adverse effect on our business.

Decreases in discretionary consumer spending may have an adverse effect on us.

A substantial portion of the products and services we offer are products or services that consumers may view as discretionary items rather than necessities. As a result, our results of operations are sensitive to changes in macro-economic conditions that impact consumer spending, including discretionary spending. Difficult macro-economic conditions, particularly high levels of unemployment or underemployment, also impact our customers' ability to obtain consumer credit. Other factors, including consumer confidence, employment levels, interest rates, tax rates, consumer debt levels, and fuel and energy costs could reduce consumer spending or change consumer purchasing habits. Slowdowns in the U.S. or global economy, or an uncertain economic outlook, could materially adversely affect consumer spending habits and could have a material adverse effect on our business.

### Risks Related to Our Business and Industry - Risks of Changes and Unpredictability in the Industry and in Our Business Generally

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

The Internet and the online commerce industry are changing rapidly. To remain competitive, we must continue to enhance and improve the functionality and features of our e-commerce businesses. If we fail to do so, we may lose customers. If competitors introduce new products or services using new technologies or if new industry standards and practices emerge, our Website, our mobile app and our proprietary technology and systems may become obsolete. Our

failure to respond to technological change or to adequately maintain, upgrade and develop our Website, our mobile app, our infrastructure and the numerous systems we use to process customers' orders and payments and to perform important related functions could have a material adverse effect on our business.

We have an evolving business model, which increases the complexity of our business.

Our business model has evolved in the past and continues to do so. In prior years we have added additional types of services and product offerings and in some cases we have modified or discontinued those offerings. We intend to continue to try to offer additional types of products or services, and we cannot offer any assurance that any of them will be successful. From time to time we have also modified aspects of our business model relating to our product mix and the mix of direct/partner

## Table of Contents

sourcing of the products we offer. We may continue to modify this aspect of our business as well as other significant aspects of our business. We cannot offer any assurance that these or any other modifications will be successful or will not result in harm to the business. The additions and modifications to our business have increased the complexity of our business and placed significant strain on our management, personnel, operations, systems, technical performance, financial resources, and internal financial control and reporting functions. Future additions to or modifications of our business are likely to have similar effects. We may not be able to manage growth effectively, which could damage our reputation, limit our growth and negatively affect our operating results. Further, any new business or website we launch that is not favorably received by consumers could damage our reputation or our brand. The occurrence of any of the foregoing could have a material adverse effect on our business.

Acquisitions we make will increase costs and regulatory and integration risks.

From time to time we acquire other businesses. Integrating an acquired business involves a number of risks and financial, managerial and operational challenges. The acquisition of a business and the integration of a business requires us to allocate significant management time and attention to the matter. We have incurred significant expenses in connection with acquisitions we have made recently, and may incur additional expenses in connection with those acquisitions or in connection with other acquisitions we may make in the future. Our overall profitability would be adversely affected if our investments and expenses associated with any investments we have made or may make in the future are not matched or exceeded by the revenues that are derived from such investment or growth. Further, acquisitions may also create a need for additional accounting, tax, compliance, documentation, risk management and internal control procedures, and may require us to hire additional personnel to implement, perform and/or monitor such procedures. To the extent our procedures are not adequate to appropriately implement, perform and/or monitor all necessary procedures relating to any new or expanded business, we could be exposed to a material loss or regulatory sanction.

### Risks Related to Our Business and Industry - International Risks

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

We sell products in international markets, and are attempting to expand into some of these markets. International sales and transactions, and our efforts to expand them, are subject to inherent risks and challenges that could adversely affect our profitability, including:

- the need to develop new supplier and manufacturer relationships;
- the need to comply with additional U.S. and foreign laws and regulations to the extent applicable, including but not limited to, restrictions on advertising practices, regulations governing online services, regulations governing or prohibiting the use of cryptocurrencies, such as bitcoin, restrictions on importation of specified or proscribed items, importation quotas, consumer protection laws, laws regarding intellectual property rights, laws dealing with consumer and data protection, privacy, encryption, and restrictions on pricing or discounts;
- changes in international laws, regulatory requirements, taxes and tariffs;
- geopolitical events, such as war and terrorist attacks;
- our limited experience with different local cultures and standards;
- the risk that the products we offer may not appeal to customers in international markets; and
- the additional resources and management attention required for such expansion.

To the extent we generate international sales transactions in the future, any negative impact on our international operations could negatively impact our business. To date, most of our international sales have been denominated in U.S. dollars, and we have not had significant foreign currency risk on those sales. However, in the future, gains and

losses on the conversion of foreign payments into U. S. dollars may contribute to fluctuations in our results of operations and fluctuating exchange rates could cause reduced gross revenues and/or gross profit percentages from non-dollar-denominated international sales. Additionally, penalties for non-compliance with laws applicable to international business and trade, including the U.S. Foreign Corrupt Practices Act, or laws governing or prohibiting the use of cryptocurrencies, could have a material adverse effect on our business.

Foreign data protection, privacy and other laws and regulations are often more restrictive than those in the United States. The European Union, for example, traditionally has imposed stricter obligations under its laws and regulations relating



## Table of Contents

to privacy, data protection and consumer protection than the United States. Individual EU member countries have discretion with respect to their interpretation and implementation of these laws and the penalties for breach and have their own regulators with differing attitudes towards enforcement, which results in varying privacy standards and enforcement risk from country to country. Legislation and regulation in the European Union and some EU member states require companies to give specific types of notice and in some cases seek consent from consumers before using their data for certain purposes, including some marketing activities. In the majority of EU member countries, consent must be obtained prior to setting cookies or other tracking technologies. Outside of the European Union, there are many countries with data protection laws, and new countries are adopting data protection legislation with increasing frequency. Many of these laws may require consent from consumers for the use of data for various purposes, including marketing, which may reduce our ability to market our products, unless we obtain consent from customers in a manner that complies with the laws of each country. In addition, even if we initially receive such consent, many countries have laws in place that allow consumers to revoke their consent. This imposes multiple obligations around tracking, auditing, and updating consumer consents, as well as the activities that required the consent, such as marketing. There is no harmonized approach to these laws and regulations globally. Consequently, we increase our risk of non-compliance with applicable foreign data protection laws and regulations as we continue our international expansion. We may need to change and limit the way we use consumer information in operating our business and may have difficulty maintaining a single operating model that is compliant. Compliance with such laws and regulations will result in additional costs and may necessitate changes to our business practices and divergent operating models, which may adversely affect our business and financial condition.

On July 12, 2016, the European Commission adopted the EU-US Privacy Shield, which provides a new compliance framework for US organizations that import personal data from Europe and effectively replaces the EU-U.S. safe harbor which was overturned by the European Court of Justice in October 2015. We have complied with the Privacy Shield self-certification procedures. Among other things, Privacy Shield certification requires that we amend our existing contracts with third parties involved with the transfer of personal data to bring them into compliance within a nine-month grace period after our certification date. If we are unable to do so or are otherwise unable to comply with the Privacy Shield requirements, we could incur additional costs and operational difficulties relating to our efforts in Europe.

In addition, various federal, state and foreign legislative and regulatory bodies, or self-regulatory organizations, may expand current laws or regulations, enact new laws or regulations or issue revised rules or guidance regarding privacy, data protection and consumer protection.

Our foreign brand domain name may cause confusion.

In 2010, we attempted to associate our brand globally with the domain address: www.O.co. We did this in part because in many foreign markets the word “Overstock” lacked a good foreign cognate. Following a period of testing for the O.co brand and domain address, we returned to the Overstock.com name as our primary brand domestically because domestic consumer acceptance did not occur as quickly as we had hoped. While we have returned domestically to the Overstock.com brand and principal domain address, we continue to use the O.co address and brand outside of the United States and plan to use it or another domain address and brand domestically as well. The use of Overstock.com or O.co may not gain acceptance or have success in foreign markets, and other domain addresses or brands we may use domestically may not be successful. Any such difficulties with any of our brands could have a material adverse effect on our business.

### Risks Related to Our Business and Industry - Risks relating to our Headquarters

We own the land on which we built our new headquarters, and consequently have environmental and other risks, and may incur environmental expense and liabilities under the environmental indemnity agreement we entered into in

connection with our credit facility.

In the third quarter of 2014, we purchased land near Salt Lake City, Utah on which to build our new headquarters. In purchasing the land, we became subject to the risks of owning real estate, including the risks of environmental liabilities and the requirements for compliance with applicable laws, rules, regulations, ordinances and other requirements. The land we purchased is part of the Midvale Slat Superfund Site ("Site"), a former Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") superfund site that was remediated pursuant to CERCLA prior to our purchase. As purchaser of the property, O.com Land, LLC is required to follow certain requirements of the CERCLA statute and the consent decree governing remediation of the Site. Its failure to do so could expose us to environmental liabilities which could be material. Further, in connection with the credit facility we entered into with U.S. Bank and other banks, we entered into a broad

Table of Contents

environmental indemnity agreement pursuant to which we made detailed representations about the environmental status of the land and agreed to indemnify and defend U.S. Bank and other banks and other persons against a broad array of potential environmental claims, liabilities and exposures relating to the property we purchased and the headquarters we are building. Any such environmental liabilities, and any liabilities under the environmental indemnity agreement, could be material and could have a material adverse effect on our business.

We have entered into contracts and plan to spend approximately \$99 million to build, equip and furnish a facility to serve as our headquarters, and have incurred risks, expense and debt in connection with the project.

We have completed the construction of our new headquarters near Salt Lake City, Utah, and have completed our move from our old corporate headquarters into the new facility, and we incurred a number of risks and significant expense in doing so. The design and construction of the headquarters were complicated. We may encounter unanticipated developments as we complete our transition into the new facility, and any such developments could adversely affect our estimates regarding the expense of the project. Any such difficulties could result in our default under the Loan Agreement and related agreements we have entered into with U.S. Bank and other banks, and could result in material liabilities and expense and could have a material adverse effect on our business.

In connection with the construction of our new headquarters, we entered into a syndicated senior secured credit facility, and may need to obtain additional financing as well.

Our current estimate of the total cost of the development and construction and related equipment and furniture of our new headquarters remains approximately \$99 million, and we have incurred and paid substantially all of those costs. We have a syndicated senior secured credit facility with U.S. Bank and other banks that provided us with construction financing of \$45.8 million. The facility is designed to convert to an approximately 6.75-year term loan in January 2017 (but no later than April 2017), subject to our satisfaction of a number of conditions. We will need to maintain compliance with the requirements governing the facility, including compliance with financial and other covenants, certain of which may be subject to events outside of our control. If we fail to comply with any of such covenants, the loan might not convert into a term loan which would have a material adverse effect on our liquidity and would have a material adverse effect on our business.

We have pledged the land and our new headquarters and all related assets, as well as our inventory and accounts receivable and related assets, to secure our obligations under the syndicated senior secured credit facility.

We have pledged all of our assets relating to the new headquarters and the site on which it is located, as well as our inventory, accounts receivable and related assets, and most of our deposit accounts, to secure our obligations under the syndicated senior secured credit facility. The real estate loan and the revolving loan facilities included within the facility are cross-collateralized and cross-defaulted. If we were to default on either loan or have an Event of Default under the facility, the lenders would have the right to, among other things, foreclose on the collateral for our obligations under the facility, which would have a material adverse effect on our liquidity and would have a material adverse effect on our business.

We have entered into long-term interest rate swaps covering a period of approximately nine years.

In connection with the syndicated senior secured credit facility described above, we entered into interest rate swaps with U.S. Bank and Compass Bank. The interest rate swaps are intended to manage the interest rate risk on the indebtedness we incurred for the Real Estate Loan. However, if for any reason the notional amounts of the swaps fail to substantially match our indebtedness for the Real Estate Loan at any time until the October 2023 maturity of the swaps, we could potentially be exposed to liabilities under the loan agreement that may not be substantially offset by the interest rate swap. If the lenders under the senior secured credit facility were to fail to fund any portion of the Real

Estate Loan for any reason, we would remain liable for payments due under the swaps unless we were to settle the swaps. If we were to settle the swaps at a time when interest rates have fallen (relative to the swaps' inception), the price to settle the swaps could be material. Any such adverse developments could result in material liabilities and expense and could have a material adverse effect on our business.

We may fail to qualify for hedge accounting treatment.

In connection with the financing we obtained to fund a portion of the construction of our new corporate headquarters, we entered into interest rate swap transactions with certain of our lenders intended to minimize our exposure to various interest rate risks. At inception in 2014 we designated these swaps as cash flow hedges in accordance with Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging. However, in the future, we may fail to qualify for hedge accounting

Table of Contents

treatment under these standards for a number of reasons, including if we fail to satisfy hedge documentation and hedge effectiveness assessment requirements or if our derivative instruments are not highly effective. If we fail to qualify for hedge accounting treatment, losses on the swaps caused by the change in their fair value would be recognized as part of net income, rather than being recognized as part of other comprehensive income. Additionally, although our derivative instruments may be highly effective, ineffectiveness in such instruments would also be recognized as part of net income, rather than other comprehensive income. Any such adverse developments could result in material liabilities and expense and could have a material adverse effect on our business.

Risks Related to Our Business and Industry - Risks relating to Indebtedness and Potential Stock Repurchases

We have incurred substantial indebtedness.

At September 30, 2016, we had incurred secured indebtedness of \$40.9 million under the syndicated senior secured credit facility we recently entered into with U.S. Bank and other banks. All such indebtedness increases our business risks substantially, including our vulnerability to industry downturns and competitive pressures. Further, the Loan Agreement and related agreements governing the senior secured credit facility contain numerous requirements, including affirmative and negative financial and other covenants. If we are unable to maintain compliance with all of them, we will be in default, the consequences of which could materially harm our business. Further, to the extent that we incur additional indebtedness, we may be subject to additional requirements. The degree to which we are ultimately leveraged could materially and adversely affect our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

Our Board has authorized a stock repurchase program and repurchases under the program would reduce our liquidity and increase our risks.

In May 2015 our Board authorized a stock repurchase program under which we may repurchase shares of our outstanding common stock for up to \$25 million at any time through December 31, 2017. Any such repurchases would reduce our liquidity and could increase our vulnerability to industry downturns and competitive pressures. A material decrease in our liquidity could have a material adverse effect on our business.

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

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

Risks Related to Our Business and Industry - Risks relating to our Finance and Accounting Systems and Estimates

We may need to implement additional finance and accounting systems, procedures and controls as we grow our business and organization and to satisfy new reporting requirements.

We are required to comply with a variety of reporting, accounting and other rules and regulations, including for the fintech company and broker dealers we recently acquired. Compliance with existing requirements is expensive and may increase our costs and require additional management time and resources. We may need to implement additional finance and accounting systems, procedures and controls to satisfy our reporting requirements. If our internal control over financial reporting is determined to be ineffective, such failure could cause investors to lose confidence in our reported financial information, negatively affect the market price of our common stock, subject us to regulatory investigations and penalties, and could have a material adverse effect on our business.

Table of Contents

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial results.

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including but not limited to revenue recognition, estimating valuation allowances and accrued liabilities (including allowances for returns, credit card chargebacks, doubtful accounts and obsolete and damaged inventory), internal-use software and website development (acquired and developed internally), accounting for income taxes, valuation of long-lived and intangible assets and goodwill, stock-based compensation and loss contingencies, are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance, and could have a material adverse effect on our business.

Our income tax provisions and the amounts we reserve for tax contingencies are estimates and are subject to variations and adjustments. The amounts we ultimately pay may exceed the amounts estimated or accrued.

Our quarterly tax provision, and our quarterly estimate of our annual effective tax rate, is subject to significant variation due to several factors, including variability in accurately predicting our pre-tax and taxable income and loss and the mix of jurisdictions to which they relate, changes in how we do business, changes in law, regulations, and administrative practices, and relative changes of expenses or losses for which tax benefits are not recognized. Additionally, our effective tax rate can be more or less volatile based on the amount of pre-tax income. For example, the impact of discrete items and non-deductible expenses on our effective tax rate is greater when our pre-tax income is relatively low.

Changes in state, federal, and foreign tax laws may increase our tax contingencies. The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ from the amounts accrued. It is reasonably possible that within the next 12 months we will receive assessments by various tax authorities or possibly reach resolution of income tax examinations in one or more jurisdictions. These assessments or settlements may result in changes to our contingencies related to positions on prior years' tax filings. The volatility of our quarterly tax provision or the resolution of matters related to our tax contingencies could have a material adverse effect on our financial results.

We have reversed the valuation allowance for our deferred tax assets, and we may not be able to realize these assets in the future. Our deferred tax assets may also be subject to additional valuation allowances, which could adversely affect our operating results.

From our inception to December 31, 2013, we established a valuation allowance for our deferred tax assets, primarily due to realized losses and uncertainty regarding our future taxable income. Determining whether a valuation allowance for deferred tax assets is appropriate requires significant judgment and an evaluation of all positive and negative evidence. At each reporting period, we assess the need for, or the sufficiency of, a valuation allowance against deferred tax assets. At December 31, 2013, based on the weight of all the positive and negative evidence, we concluded that it was more likely than not that we will realize our net deferred tax assets based upon future taxable income. Therefore we reversed the valuation allowance at December 31, 2013.

Our conclusion at December 31, 2013 that it is more likely than not that we will realize our net deferred tax assets was based primarily on our estimate of future taxable income. Our estimate of future taxable income is based on internal projections which primarily consider historical performance, but also include various internal estimates and assumptions as well as certain external data. We believe all of these inputs to be reasonable, although inherently subject to significant judgment. If actual results differ significantly from these estimates of future taxable income, we

may need to reestablish a valuation allowance for some or all of our deferred tax assets. Establishing an allowance on our net deferred tax assets could have a material adverse effect on our financial condition and operating results.

Risks Related to Our Business and Industry - Risks relating to our Holdings of Precious Metals, Cryptocurrencies, Cash and Short-Term Investments

We may be adversely affected by fluctuations in precious metal prices.



## Table of Contents

At September 30, 2016 our investment in precious metals was \$9.7 million. Our financial results may be adversely affected by declines in the price of precious metals. The prices of precious metals may fluctuate widely in the future and are affected by numerous factors beyond our control such as interest rates, exchange rates, inflation or deflation, fluctuation in the value of the United States dollar and foreign currencies, global and regional supply and demand, and the political and economic conditions of mineral producing countries throughout the world. Our investment consists of actual precious metals, rather than financial instruments. We store our precious metals off-site in a third party facility. Consequently, we are subject to the risks of physical storage with a third party that we do not control. Any loss of these assets or substantial decline in their value could have a material adverse effect on our business.

Our decision to accept and hold cryptocurrency, such as bitcoins, may subject us to exchange risk and additional tax and regulatory requirements.

In January 2014, we began accepting bitcoins as a form of payment for purchases on our Website. Bitcoin is a cryptocurrency that uses cryptography to control the creation and transfer of the currency between individual parties. Bitcoin is not considered legal tender or backed by any government. Since inception in 2009, bitcoins have experienced price volatility, technological glitches and various law enforcement and regulatory interventions. At present we do not accept bitcoin payments directly, but use a third party vendor to accept bitcoin payments on our behalf. That third party vendor then immediately converts the bitcoin payments into U.S. dollars so that we receive payment for the product sold at the sales price in U.S. dollars.

In September 2014 we launched an updated international checkout system which allows us to accept bitcoin globally. The use of cryptocurrency such as bitcoin has been prohibited or effectively prohibited in some countries. Authorities in other countries have issued statements or regulations prohibiting financial institutions or others from holding or dealing in cryptocurrency. Authorities in some countries have issued statements or regulations to the effect that cryptocurrency is not legal tender. Authorities in many other countries have issued warnings about their perceptions of the risks of dealing in bitcoin or other cryptocurrency and/or announcing that cryptocurrency is subject to money laundering or other laws or to taxation, or that the authorities are studying the legality of cryptocurrency. If we fail to comply with prohibitions applicable to us, we could face regulatory or other enforcement actions and potential fines and other consequences.

We also hold bitcoin and other cryptocurrency directly. Consequently, we have exchange rate risk on the amounts we hold as well as the risks that regulatory or other developments may adversely affect the value of the cryptocurrency we hold. In the future, we may transact in cryptocurrency directly or increase our cryptocurrency holdings. This will subject us to additional exchange risk and other risks as described above, which may have an adverse effect on our results. There is also uncertainty regarding the future legal and regulatory requirements relating to cryptocurrency or transactions utilizing cryptocurrency. These uncertainties, as well as future accounting and tax developments, or other requirements relating to cryptocurrency could have a material adverse effect on our business.

Our cash, cash equivalents and short-term investments are subject to a risk of loss based upon the solvency of the financial institutions in which they are maintained.

We maintain the majority of our cash, cash equivalents and short-term investments in accounts with a small number of major financial institutions within the United States, in the form of demand deposits, money market accounts, time deposits, U.S. Treasury Bills and other short-term investments. Our deposits in these institutions are generally substantially in excess of the amounts of insurance provided by the FDIC, and some deposits may not be covered by insurance at all. If any of these institutions were to become insolvent or subject to regulatory action, we could lose some, or all, of such deposits, which would have a material adverse effect on our business.

Risks Related to Our Business and Industry - Risks relating to Intellectual Property Rights and Disputes

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

Our success depends to a significant degree upon the protection of our software and other proprietary intellectual property rights. We may be unable to deter misappropriation of our proprietary information, detect unauthorized use or take appropriate steps to enforce our intellectual property rights. In addition, our competitors may now have or may in the future develop technologies that are as good as or better than our technology without violating our proprietary rights. Our failure to protect our software and other proprietary intellectual property rights or to utilize technologies that are as good as our competitors' could put us at a disadvantage to our competitors. In addition, the failure of the third parties whose products we

73

---

## Table of Contents

offer for sale on our Website to protect their intellectual property rights, including their domain names, could impair our operations. These failures could have a material adverse effect on our business.

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

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

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

We sell products internationally and consequently we are subject to risks of doing business internationally as related to our intellectual property, including:

- legal uncertainty regarding liability for the listings and other content provided by our users, including uncertainty as a result of less Internet-friendly legal systems, unique local laws, and lack of clear precedent or applicable law; and
- differing intellectual property laws, which may provide insufficient protection for our intellectual property.

Any such difficulties could have a material adverse effect on our business.

We may be accused of infringing intellectual property rights of third parties.

Other parties have claimed and may claim that we infringe their intellectual property rights. We have been and are subject to, and expect to continue to be subject to, legal claims of alleged infringement of the intellectual property rights of third parties. The ready availability of damages, royalties and the potential for injunctive relief has increased the defense litigation costs of patent infringement claims, especially those asserted by third parties whose sole or primary business is to assert such claims. Such claims, even if not meritorious, may result in significant expenditure of financial and managerial resources, and the payment of damages or settlement amounts. Additionally, we may become subject to injunctions prohibiting us from using software or business processes we currently use or may need to use in the future, or requiring us to obtain licenses from third parties when such licenses may not be available on financially feasible terms or terms acceptable to us or at all. In addition, we may not be able to obtain on favorable terms, or at all, licenses or other rights with respect to intellectual property we do not own in providing e-commerce services to other businesses and individuals under commercial agreements. Any such difficulties could have a material adverse effect on our business.

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

We have received in the past, and we anticipate we will receive in the future, communications alleging that items offered or sold through our Website infringe third party copyrights, trademarks and trade names or other intellectual property rights or that we have otherwise infringed third parties' past, current or future intellectual property rights. We may be unable to prevent third parties from offering and selling unlawful goods, and we may be subject to allegations of civil or criminal liability for unlawful activities carried out by third parties through our Website. We may implement measures in an effort to protect against these potential liabilities that could require us to spend substantial

resources and/or to reduce revenues by discontinuing certain service offerings. Any costs incurred as a result of liability or asserted liability relating to the sale of unlawful goods or the unlawful sale of goods could harm our business. Resolving litigation or claims regarding patents or other intellectual property, whether meritorious or not, could be costly, time-consuming, cause service delays, divert our management and key personnel from our business operations, require expensive or unwanted changes in our methods of doing business or require us to enter into costly royalty or licensing agreements, if available. As a result, these claims and any negative publicity generated as a result of any of the foregoing could damage our reputation, diminish the value of our brand name, and have a material adverse effect on our business.

Table of Contents

Risks Related to Our Business and Industry - Risks relating to Certain Specific Businesses, Investments in Businesses and Recent or Planned Changes to our Business

We have acquired the assets and business of a financial technology company and two registered broker-dealers; we do not have any prior experience with the operation of a fintech company or of a registered broker-dealer, and the businesses that we are pursuing through our Medici initiatives are novel and could result in material write-offs.

In August 2015, we acquired the assets and business of a financial technology ("fintech") company and in January 2016, after receiving FINRA approval, we acquired two registered broker-dealers (our "broker-dealer subsidiaries") that were affiliated with the fintech company. We subsequently hired all or substantially all of the employees of the fintech company. However, we do not otherwise have any experience with the operation of a fintech company or of a registered broker-dealer, and are dependent upon the new employees for the expertise necessary to operate the fintech company and the broker-dealers subsidiaries. Further, we have developed proprietary blockchain software and related expertise relating to the use of the blockchain in connection with a system for the public trading of securities, and are working on other potential financial applications of blockchain technology. All of these are areas in which we do not have substantial, or any, experience, and all of them are subject to the risks of new and novel businesses, including operational risk, financial risk, regulatory and legal risk, and reputational risk. Further, even assuming the resolution of all technical, legal and regulatory constraints, we face the risk that we may be unable to market, license or sell our technology successfully or profitably. Any significant problems we encounter with these projects could have a material adverse effect on our business. Further, we review our acquired assets for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. As described in Note 2, we will write off these amounts as necessary. Any such write-offs could be material.

We have acquired registered broker-dealers, which are subject to extensive regulation.

Broker-dealer and other financial services firms are subject to extensive regulatory requirements under federal and state laws and regulations and self-regulatory organization ("SRO") rules. The broker-dealers we acquired in January 2016 are registered with the SEC as broker-dealers under the Exchange Act and in the states in which they conduct securities business and are members of the Financial Industry Regulatory Authority ("FINRA") and other SROs. They are subject to regulation, examination and disciplinary action by the SEC, FINRA and state securities regulators, as well as other governmental authorities and SROs with which they are registered or licensed or of which they are members.

The SEC, FINRA and other governmental authorities and SROs may bring enforcement proceedings against firms and place other limitations on firms subject to their jurisdiction, as well as their officers, directors, employees and independent contractors, whether arising out of an examination or otherwise, for violations of the securities laws, regulations and rules. Sanctions can include cease-and-desist orders, censures, fines, civil monetary penalties and disgorgement, limitations on a firm's business activities, suspension, revocation of FINRA membership or expulsion of the firm from the securities industry. Criminal actions are referred to the appropriate criminal law enforcement agency. Any such proceeding against any of the broker-dealers that we have acquired, or any of their associated persons, could harm our reputation, cause them to lose clients or fail to gain new clients and have a material adverse effect on our business.

Financial services firms are subject to numerous conflicts of interest or perceived conflicts of interest. The SEC, FINRA and other governmental authorities and SROs have increased their scrutiny of potential conflicts of interest. The broker dealers have adopted and will regularly review and update, policies, procedures and controls designed to address or limit actual or perceived conflicts, but there can be no assurance of the effectiveness of these protocols. Addressing conflicts of interest adequately is complex and difficult and our reputation could be damaged if we fail, or appear to fail, to identify and successfully manage these conflicts of interest. The development and implementation of

policies, procedures and controls to address or limit actual or perceived conflicts may also result in increased costs. Failure to identify and successfully manage conflicts of interest procedures could subject the broker-dealers or us to disciplinary sanctions or litigation or could harm our reputation. Any of the foregoing could have a material adverse effect on our business.

Financial services firms are also subject to rules and regulations relating to the prevention and detection of money laundering. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act") mandates that financial institutions, including broker-dealers and investment advisers, establish and implement anti-money laundering ("AML") programs reasonably designed to achieve compliance with the Bank Secrecy Act of 1970 and the rules thereunder. Financial services firms must maintain AML policies, procedures and controls, designate an AML compliance officer to oversee the firm's AML program, implement appropriate employee training

## Table of Contents

and provide for annual independent testing of the program. Failure to comply with AML requirements could subject the broker-dealers and/or us to disciplinary sanctions and other penalties, which could have a material adverse effect on our business.

Financial services firms must also comply with applicable privacy and data protection laws and regulations. Any violations of laws and regulations relating to the safeguarding of private information could subject the broker-dealers and/or us to fines and penalties, as well as to civil action by affected parties, which could have a material adverse effect on our business.

Our ability to comply with applicable laws, rules and regulations is largely dependent on our establishment and maintenance of compliance, supervision, recordkeeping and reporting and audit systems and procedures, and our ability to attract and retain qualified compliance, audit and risk management personnel, including for the broker dealers we recently acquired. While we have adopted policies and procedures intended to comply with applicable laws, rules and regulations, regulators or third parties may raise issues with respect to past or future compliance with applicable regulations, which could have a material adverse effect on our business.

Our investment in Bitt Inc. may expose us to risks under laws and regulations with which we do not have significant experience.

In 2016 we acquired an approximately 11% equity interest in Bitt, Inc., a startup company based in Barbados, that is pursuing a variety of digital currency transfer and payment businesses in the Caribbean. Virtually every state in the U.S. regulates money transmitters and money services businesses. In some states the licensing requirements and regulations expressly cover companies engaged in digital currency activities; in other states it is not clear whether or how the existing laws and regulations apply to digital currency activities. Further, U.S. federal law requires registration of most such businesses with the Financial Crimes Enforcement Network ("FinCEN"). These licenses and registrations subject companies to various anti-money laundering, know-your-customer, record-keeping, reporting and capital and bonding requirements, limitations on the investment of customer funds, and inspection by state and federal regulatory agencies. Under U.S. federal law, it is a crime for a person, entity or business that is required to be registered with FinCEN or licensed in any state to fail to do so, even if the person, entity or business was unaware of the licensing requirement. Further, under U.S. federal law, anyone who owns all or part of an unlicensed money transmitting business is subject to civil and criminal penalties. The business in which we have invested has represented to us that it has not taken any action that could subject it to registration with FinCEN or to the licensing requirements in any state and has agreed that it will not do so until it has become properly licensed in all required states and registered with FinCEN. However, if the business makes an error, even if inadvertently, we could be subject to potential civil and criminal penalties as a result. Any such penalties, or even the allegation of criminal activities, could have a material adverse effect on us and our business. Further, as described under Governmental Regulation, all of our foreign business activities expose us to a variety of risks, including risks under the Foreign Corrupt Practices Act.

We may be required to write off amounts relating to our investments in startup businesses.

At September 30, 2016, we had invested approximately \$13.9 million in several companies that are in the startup or development stages. These investments are recognized as cost method investments or as described under "Cost and equity method investments" under Note 2-Accounting Policies contained in the "Notes to Consolidated Financial Statements" in Item 1 of Part I of this Quarterly Report on Form 10-Q. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. As described in Note 2, we have written off amounts related to cost method investments and we may write off additional amounts as necessary. Any such write-offs could be material.

We could be liable for fraudulent or unlawful activities of sellers.

The law relating to the liability of providers of online payment services is currently unsettled. In addition, governmental agencies could require changes in the way this business is conducted. Under our seller programs, we may be unable to prevent sellers from collecting payments, fraudulently or otherwise, when buyers never receive the products they ordered or when the products received are materially different from the sellers' descriptions. We also may be unable to prevent sellers on our sites or through other seller sites from selling unlawful goods, selling goods in an unlawful manner, or violating the proprietary rights of others, and could face civil or criminal liability for unlawful activities by our sellers. Any such events could have a material adverse effect on our business.

Our car listing service may be subject to a variety of regulatory requirements and risks.



## Table of Contents

Many states and other jurisdictions, including Utah, where we are located, have regulations governing the conduct of car sellers and public advertisement for car sales. Generally, these regulations govern the conduct of those sellers advertising their automobiles for sale and are not directly applicable to those providing the medium through which the advertisement is made available to the public. Sellers are often subject to regulations in the nature of “truth in advertising laws.” We have no ability to know whether the information sellers provide is correct. While our site terms and conditions of usage prohibit unlawful acts, we cannot assure that sellers will comply with all laws and regulations applicable to them and their transactions. The application of these regulations to online car listing service providers is not clear. Although we do not expect these laws to have a significant effect on our listing service, we will incur costs in complying with these laws, and we may from time to time be required to make changes in our service that may increase our costs, reduce our revenues, cause us to prohibit certain listing or advertising practices, or make other changes that may adversely affect our car listing service. Further, like our shopping business, our car listing service is subject to most of the same laws and regulations that apply to other companies conducting business on and off the Internet. To the extent that current or future laws or regulations prevent users from selling items on our car listing site, they could harm our business. In addition, any negative publicity we receive regarding any allegations of unlawful or deceptive conduct may damage our reputation, our ability to attract new customers to our main shopping site, and our brand name generally. The occurrence of any of the foregoing could have a material adverse effect on our business.

Our Supplier Oasis offering, including its fulfillment services, faces competition from other distribution networks and will require substantial resources.

We recently launched Supplier Oasis, a single integration point through which partners can manage their products, inventory and sales channels, which includes multi-channel fulfillment services to sellers, suppliers, and partners. The marketplace for these services is highly competitive, and many of our current and potential competitors in this area have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Our continued development of Supplier Oasis may require substantial investments over a lengthy period of time. Further, most of the risks applicable to our business generally are also applicable to the business of Supplier Oasis. If we are unable to generate sufficient revenues and gross profits from Supplier Oasis, it could have a material adverse effect on our business.

Our recently-launched Farmers Market faces competition from a variety of competitors.

In late 2014 we launched Farmers Market, a tab within our Website from which our customers can order locally grown fresh produce and other food products. Farmers Market competes with a wide variety of businesses nationwide, many of which have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Our continued development of Farmers Market may involve delivery and other issues that may be different from those we face in connection with the sale and delivery of non-perishable products. Further, most of the risks applicable to our business generally are also applicable to our Farmers Market business. Any significant difficulties we encounter with our Farmers Market offering could have a material adverse effect on our business.

Our insurance offerings face competition from traditional insurance brokers and direct insurance marketing organizations.

In 2014 we launched a tab offering insurance for vehicle, residential and small businesses on our Website. The tab allows consumers to compare live quotes for insurance on residential, vehicle, and small business insurance, and to bind (pay for and have go into effect) insurance policies. The insurance business is highly competitive, and many of our current and potential competitors in this area have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources than we do. Further, most of the risks applicable to our business generally are also applicable to our insurance offerings business. Any significant

difficulties we encounter with our insurance offerings could have a material adverse effect on our business.

Risks Related to Our Business and Industry - Risks relating to Litigation

We are involved in substantial litigation.

From time to time we receive claims of and become subject to consumer protection, employment, intellectual property and other commercial litigation related to the conduct 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 or equitable remedies. In addition, we have in the past been and in the future may be, involved in substantial litigation in which we are the plaintiff, including litigation regarding the constitutionality of certain state tax laws. Any of such litigation, whether as plaintiff or defendant, could be costly and time

## Table of Contents

consuming and could divert management and key personnel from our regular business operations. We do not currently believe that any of our outstanding litigation will have a material adverse effect on our business, prospects, financial condition or results of operations. However, 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 have a material adverse effect on our business.

### Risks Related to Our Business and Industry - Risks relating to our Common Stock

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

The market price of our common stock historically has been subject to significant fluctuations. These fluctuations could continue. It is possible that in future periods our results of operations may be below the expectations of public market analysts and investors. If this occurs, the market price of our securities may decline substantially. Any of the foregoing could have a material adverse effect on our business and particularly on our ability to raise capital.

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

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

- increases in the cost of advertising and changes in our sales and marketing expenditures;
- our inability to retain existing customers or encourage repeat purchases;
- the extent to which our existing and future marketing campaigns are successful;
- price competition that results in losses or lower profit margins;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business operations and infrastructure;
- the amount and timing of our purchases of inventory;
- our inability to manage distribution operations or provide adequate levels of customer service;
- increases in the cost of fuel and transportation;
- our ability to successfully implement technology changes or to integrate operations and technologies from acquisitions or other business combinations;
- our efforts to offer new lines of products and services; and
- our ability to attract users to our shopping and other sites.

Any of the foregoing could have a material adverse effect on our business.

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

We have experienced and expect to continue to experience fluctuations in our operating results because of seasonal fluctuations in traditional retail patterns. Sales in the retail and wholesale industry tend to be significantly higher in the fourth calendar quarter of each year than in the preceding three quarters due primarily to increased shopping activity during the holiday season. Nevertheless, our sales in the fourth quarter of a given year may not exceed those of the preceding quarters. Moreover, if the fourth quarter sales do exceed those of the preceding quarters, we may not be able to manage the increased sales effectively. Further, we generally increase our inventories substantially in anticipation

of holiday season shopping activity, which has a negative effect on our cash flow. Securities analysts and investors may inaccurately estimate the effects of seasonality on our results of operations in one or more future quarters and, consequently, our operating results may fall below expectations, causing the market price of our securities to decline. Any of the foregoing could have a material adverse effect on our business.

Sales by our significant stockholders could have an adverse effect on the market price of our stock.

Several of our stockholders own significant percentages of our common stock. If one or more of our large stockholders were to sell all or a portion of their holdings of our common stock, the market price of our common stock could be negatively

## Table of Contents

impacted. The effect of such sales, or of significant percentages of our stock being offered or made available for sale, could result in strong downward pressure on our stock price. Investors should be aware that they could experience significant volatility in our stock if any one or more of such stockholders were to decide to sell all or a portion of their holdings of our common stock at once or within a short period of time. In addition, the transfer of ownership of a significant portion of our outstanding shares within a three-year period could adversely affect our ability to use our net operating losses to offset future taxable net income. Any of the foregoing could have a material adverse effect on our business.

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

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

Provisions in our amended and restated certificate of incorporation and bylaws and Delaware law might discourage, delay or prevent a change of control of our company or changes in our management.

Our amended and restated certificate of incorporation and bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions among other things:

- permit the board of directors to establish the number of directors;
- provide that only one-third of our board of directors is elected at each of our annual meetings of stockholders (and our amended and restated certificate of incorporation prohibits cumulative voting in the election of directors);
- mean that directors may be removed by the affirmative vote of the holders of the outstanding shares of common stock only “for cause;”
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan (also known as a “poison pill”);
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws;
- establish advance notice requirements, including specific requirements as to the timing, form and content of a stockholder’s notice, for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings;
- provide that special meetings of our stockholders may be called only by the board of directors, the chairman of the board, the chief executive officer or the president; and
- provide that stockholders are permitted to amend the bylaws only with the approval of the holders of sixty-six and two-thirds percent (66-2/3%) of the voting power of outstanding capital stock entitled to vote at an election of directors.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a period of three years following the date the person became an interested stockholder, subject to certain exceptions.

Our board of directors could accelerate the vesting of outstanding restricted stock units upon a sale of the company or otherwise, which could result in an increase in the number of shares outstanding.

Our board has granted, and in the future expects to make additional grants, of restricted stock units (“RSUs”) to certain of our employees and directors. Upon vesting, one share of our common stock is issued for every RSU held. Under the terms of these grants, the board could determine to accelerate the vesting of RSUs in the event of a sale of our company or otherwise, which could result in an increase in the number of shares outstanding, which could dilute shareholders’ ownership of our company.

## Table of Contents

We may issue preferred stock as authorized by our amended and restated certificate of incorporation without further stockholder approval for purposes unrelated to any stockholder rights plan, and any such preferred stock could entitle the holders to rights superior to those of the holders of our common stock.

Our amended and restated certificate of incorporation authorizes our Board to designate and issue preferred stock on such terms as may be approved by the Board without further stockholder approval. In addition to the possibility that the Board could do so in connection with the adoption of a stockholder rights plan as described above, the Board could do so for a variety of other purposes.

The price of our stock may be vulnerable to manipulation.

The practice of “abusive naked short selling” places our stock at risk for manipulative attacks by large investment pools and prime brokers. Abusive naked short selling is the practice by which short sellers place large short sell orders for shares without first borrowing the shares to be sold, or without having first adequately located such shares and arranged for a firm contract to borrow such shares prior to the delivery date set to close the sale. While selling broker-dealers are by rule required to deliver shares to close a transaction by a certain date, and while purchasing broker-dealers are obligated by rule to purchase the sold quantity of shares when they are not delivered to close the sale, these rules are often ignored. Abusive naked short selling has a depressive effect on share prices when it is allowed to persist because the economic effect of abusive naked short selling is the oversupply of counterfeit stock to the market. We believe the regulations designed to address this abusive practice are both inadequately structured and inadequately enforced. Consequently, we believe that without the enactment of adequate regulations and the enforcement necessary to curb these abuses, the manipulations achieved through abusive naked short selling are likely to continue. We believe that our stock has been subject to these abusive practices by those attempting to manipulate its price downward. To the extent that our stock is subject to these practices in the future, our stock may be more volatile than it might otherwise be and/or may trade at prices below those that might prevail in the absence of such abuses.

In the past, our stock has consistently been on the Regulation SHO threshold list.

Regulation SHO requires the stock exchanges to publish daily a list of companies whose stock has failures-to-deliver above a certain threshold. It also requires mandatory close-outs for open fail-to-deliver positions in threshold securities persisting for over 13 days, with the aim that no security would appear on the threshold for any extended period. Despite that aim, our common stock has frequently appeared on the Regulation SHO threshold list for extended and continuous periods and, while we do not currently appear on the Regulation SHO threshold list, in the past our stock has been on the list for more trading days than any other company.

Any investment in our securities involves a high degree of risk. Investors should consider carefully the risks and uncertainties described above, and all other information in this Form 10-Q and in any reports we file with the SEC after we file this Form 10-Q, before deciding whether to purchase or hold our securities. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also become important factors that may harm our business. The occurrence of any of the risks described in this Form 10-Q could harm our business. The trading price of our securities could decline due to any of these risks and uncertainties, and investors may lose part or all of their investment.

We generally have not received significant coverage by securities analysts, and the lack of coverage may adversely affect our share price and trading volume.

We generally have not received significant coverage by securities analysts, and the lack of coverage may adversely affect our share price and trading volume. The lack of coverage may cause our share price or trading volume to be lower than they might be if more analysts covered us.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

80

---



Table of Contents

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

31.1 Exhibit 31.1 Certification of Chief Executive Officer

31.2 Exhibit 31.2 Certification of Chief Financial Officer

32.1 Exhibit 32.1 Section 1350 Certification of Chief Executive Officer

32.2 Exhibit 32.2 Section 1350 Certification of Chief Financial Officer

99.1 Executive Retention Plan, adopted July 27, 2016 (incorporated by reference to Exhibit 99.1 of our Current Report on Form 8-K filed on August 2, 2016 (File No. 000-49799)).

101 The following financial information from our Quarterly Report on Form 10-Q for the third quarter of 2016, filed with the SEC on November 3, 2016, formatted in Extensible Business Reporting Language (“XBRL”): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statements of Stockholders’ Equity, and (vi) Notes to Consolidated Financial Statements.

Table of Contents

SIGNATURE

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

Date: November 3, 2016 OVERSTOCK.COM, INC.

/s/ ROBERT P. HUGHES  
Robert P. Hughes  
Senior Vice President, Finance and Risk Management